This sample document is derived from a sample document that was the work product of a coalition of attorneys who specialize in venture capital financings working under the auspices of the National Venture Capital Association (the "NVCA") (the "NVCA sample document". See the NVCA website at www.nvca.org for a list of the Working Group members. The NVCA sample document has been modified by the Corporations Committee of the Business Law Section of the State Bar of California for use by California corporations. The members of the Corporations Committee who had primary responsibility for modifying the NVCA sample documents for use by California corporations are Lemoine Skinner III, Bruce R. Deming, Matthew R. Gemello, Steven R. Harmon, Mark T. Hiraide, William Sawyers, David M. Serepca, James Thompson, and Bertha Cortes Willner. Robert Brigham of the NVCA Working Group reviewed these modifications. This document is intended to serve as a starting point only, and should be tailored to meet your specific requirements. This document should not be construed as legal advice for any particular facts or circumstances. Note that this sample presents an array of (often mutually exclusive) options with respect to particular deal provisions. This sample document is based on the NVCA document whose date is set forth in the footer and does not reflect changes in that document.

AMENDED AND RESTATED
ARTICLES OF INCORPORATION

Preliminary Notes

General.

The Articles of Incorporation are a key document produced in connection with a venture capital portfolio investment. Among other things, the Corporation's Articles of Incorporation establish the rights, preferences, privileges and restrictions of each class and series of the Corporation's stock.

No Impairment Clause.

It is not uncommon for counsel to the investors to include a "no impairment" clause when they draft the amended Articles of Incorporation. A "no impairment" clause is a broad and general provision which prohibits the Corporation from acting (or failing to act) in a way which would circumvent the express and specific provisions of the Articles of Incorporation. Such provisions can be dangerous, both to the Corporation and to the controlling investors, because they can give rise to claims of violation by disgruntled minority investors looking for some grounds on which to base a claim, in the absence of any specific protective provisions in the Articles. In addition, if appropriate attention is paid to the specific, substantive provisions of the Articles of Incorporation, there is no need for a vague catch-all. Accordingly, the drafters intentionally did not include a "no impairment" clause in this form.[1]

Pay-to-Play Provision.

The Amended and Restated Articles of Incorporation include two alternative "pay-to-play" provisions, pursuant to which Preferred Stock investors are disadvantaged if they fail to invest to a specified extent in certain future rounds of financing. One of the provisions converts some or all of the Preferred Stock held by non-participating investors into Common Stock. The alternative provision converts some or all of the Series A Preferred Stock held by non-participating investors into a new series of Preferred Stock (Series A-1 Preferred Stock) nearly identical to the Series A Preferred Stock, but with no anti-dilution protection and no further pay-to-play provision.

In order to effect the conversion of non-participating Series A Preferred Stock into Series A-1 Preferred Stock, it will generally be necessary to file a Certificate of Determination with the California Secretary of State authorizing the Series A-1 Preferred Stock.[2] *The Certificate of*

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[1] A narrower "no impairment" clause is sometimes included in the anti-dilution provisions to prevent circumvention by an unusual or unanticipated transaction.

[2] An alternative approach would be to authorize the Series A-1 Preferred Stock and designate its terms as part of the same restated articles or articles amendment that authorizes the Series A Preferred Stock, and to include a prohibition on the issuance of Series A-1 Preferred Stock except pursuant to the pay-to-play provision. While this avoids the necessity of filing a Certificate of Determination in the future and avoids any ambiguity about what the terms of the Series A-1 Preferred Stock will be, there are two principal disadvantages to this approach. First, it is possible that the Series A Preferred Stock pay-to-play provision will be triggered on more than one occasion, creating the need for more than one "shadow series" of Series A Preferred Stock, which makes it more difficult to authorize all of the required "shadow series" at the time the Series A Preferred Stock is authorized.

Determination may not effect any change in the terms of the Series A Preferred, but rather may only layer the new series on top of the existing series. Hence, for purposes of effecting a pay-to-play provision of this variety, we have included language in the dividend and liquidation sections that contemplates that a new series might be added (pursuant to the blank check provisions) that is on parity with or junior to the Series A Preferred Stock.

Choice of Jurisdiction.

This form is designed for a portfolio company incorporated in California. Although Delaware is generally the preferred jurisdiction of incorporation for venture-backed companies,[3] if the company is located in California, the application of Section 2115 of the California Corporations Code (the "Corporations Code"), may make it advisable to incorporate in California.

Section 2115 of the Corporations Code provides that certain provisions of California corporate law are applicable to foreign corporations (e.g., corporations incorporated in Delaware), to the exclusion of the law of the state of incorporation, if more than half of the corporation's shareholders and more than half its "business" (a defined formula based on property, payroll and sales) are located in California ("quasi-California corporations"). As a result, some companies based in California may be subject to certain provisions of California corporate law despite being incorporated in another state, such as Delaware. Section 2115 does not apply to public companies listed on the New York Stock Exchange, the American Stock Exchange, or the NASDAQ National Market.

The validity of Section 2115 is uncertain and may turn on the jurisdiction in which the question is litigated. In Vantage Point Venture Partners v. Examen, Inc., 871 A.2d 1108 (Del. 2005), the Delaware Supreme Court held that the application of Section 2115 to a quasi-California corporation incorporated in Delaware would violate the Commerce Clause of the U. S. Constitution. The California Court of Appeals in Wilson v. Louisiana-Pacific Resources, Inc.

Second, it is possible that the anti-dilution provisions of the Series A Preferred Stock would have resulted in an adjustment to the Series A Conversion Price prior to the transaction triggering the pay-to-play provision. Because the Series A-1 Preferred Stock must have a Conversion Price equal to the Series A Conversion Price immediately prior to the transaction triggering the pay-to-play provision, the drafter would have to build in a mechanism for adjusting the Series A-1 Conversion Price coincident with adjustments to the Series A Conversion Price that occur before the Series A-1 Preferred Stock is issued, rather than simply stipulating the applicable Series A-1 Conversion Price at the time the Series A-1 Preferred Stock is created by a Certificate of Determination.

[3] Delaware is generally the preferred jurisdiction for incorporation of venture-backed companies for many reasons, including:

a.. the DGCL is a modern, current and internationally recognized and copied corporation statute which is updated annually to take into account new business and court developments;

b. Delaware offers a well-developed body of case law interpreting the DGCL, which facilitates certainty in business planning;

c. the Delaware Court of Chancery is considered by many to be the nation's leading business court, where judges expert in business law matters deal with business issues in an impartial setting; and

d. Delaware offers an efficient and user-friendly Secretary of State's office permitting, among other things, prompt certification of filings of corporate documents.

138 Cal. App.3d 216 (1982), upheld the application of Section 2115 to a quasi-California corporation.

Another consideration that may argue in favor of the incorporation of a quasi-California corporation in California is avoidance of suit in Delaware. A Delaware corporation is subject to suit in Delaware on any cause of action against the corporation. Under Section 3114 of Title 10 of the Delaware Code, every nonresident who accepts appointment as a director or officer of a Delaware corporation consents to the appointment of the registered agent of the corporation as his or her agent for service of process in all civil actions brought in Delaware by or in the right of the corporation in which the director or officer is a necessary or proper party or in any action brought against the director or officer for violation of his or her duties as director or officer. Under Section 325 of the General Corporation Law of Delaware (the "DGCL"), the directors, officers, and shareholders of a Delaware corporation may be sued in Delaware for any debt of the corporation for which they are liable.

Additionally, a quasi-California corporation incorporated in a foreign jurisdiction will incur the costs of incorporating and paying franchise tax in such jurisdiction, along with the costs of qualifying and paying tax in California.

If there is no reasonable prospect of a quasi-California corporation going public, California incorporation is generally advisable to avoid unnecessary cost, uncertainty, and administrative burden. Even where a prospect of going public exists, in view of the conflicts between Section 2115 of the Corporations Code and the DGCL and the corporate law of other jurisdictions, California incorporation may still be advisable for corporations that would otherwise be quasi-California corporations. It is always possible to reincorporate in Delaware before going public.

a. <u>Comparison of Section 2115 and Delaware Corporate Law.</u>

While a comprehensive summary of the differences between the California General Corporation Law, Division 1 of the Corporations Code[4], and the DGCL is beyond the scope of this commentary, selected differences between the provisions of the California General Corporation Law made applicable to quasi-California corporations by Section 2115 and the DGCL are summarized below.

<u>Cumulative Voting.</u> Quasi-California corporations are subject to Section 708 of the Corporations Code, which requires that shareholders be permitted to cumulate votes in the election of directors. However, Section 2115 does not require corporations to set forth this right in their articles or bylaws, and most venture backed companies that are subject to Section 2115 do not do so. There is a risk in this approach. Under Delaware law, a corporation must include a provision in its Certificate of Incorporation in order to allow cumulative voting (see Section 214 of the DGCL). Therefore, should a shareholder choose to exercise its right to cumulate votes under Sections 2115 and 708 of the Corporations Code, the corporation might find itself forced to choose between violating those provisions if it denies cumulative voting, or violating Section 214 of the DGCL if it allows it. Current California case law enforces a shareholder's rights to cumulate votes in this situation, relying on the language of Section 2115 stating that the

[4] Corporations Code Sections 100-2319.

cited provisions of the Corporations Code apply "to the exclusion of the law of the jurisdiction in which [the corporation] is incorporated." See Wilson v. Louisiana-Pacific Resources, Inc., 138 Cal. App. 3d 216 (1983). Current Delaware case law holds Section 2115 unconstitutional. See Vantage Point Venture Partners v. Examen, Inc., 871 A.2d 1108 (Del. 2005). Despite the possibility that Section 2115 of the Corporations Code may yet be held unconstitutional by the California Supreme Court or the U. S. Supreme Court, California law currently provides that the right of cumulative voting under will apply to Delaware companies subject to Section 2115 and most California practitioners continue to so advise their clients.

Removal of Directors: Unlike Delaware law, Section 303 of the Corporations Code does not permit the Articles of Incorporation to eliminate the ability of the shareholders to remove directors without cause.[5] An individual director cannot be removed under Section 303 if the votes cast against removal would be sufficient to elect the director if voted cumulatively.

Super-Majority Voting. As a general matter, Section 204(a)(5) of the Corporations Code permits super-majority voting requirements for a vote of the directors or of the outstanding shares on certain corporate actions so long as the restriction is stated in the Articles of Incorporation. However, Section 710 of the Corporations Code limits such provisions for most public and certain private California and quasi-California corporations. For applicable corporations, Section 710 imposes three primary limitations: (i) it prohibits amendment of the Articles of Incorporation to impose any voting requirement in excess of 66 2/3rds percent of the outstanding shares of an applicable class or series; (ii) it conditions adoption of such an super-majority requirement on an affirmative vote of the same percentage of the outstanding shares or class; and (iii) it makes the super-majority voting requirement inoperative two years after its adoption unless it is reapproved by the same percentage of the outstanding shares or class.[6] If applicable, such limitations may preclude adoption of super-majority protective provisions commonly sought by investors.

Shareholder Distributions. Section 500 of the Corporations Code restricts the ability of California and quasi-California corporations to make distributions of cash or property to shareholders. Corporations Code Section 166 defines "distributions to shareholders" to include all transfers of cash or property to shareholders without consideration, including dividends paid to shareholders (except stock dividends), and the redemptions or repurchases of stock by a

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[5] In addition to permitting the removal of any or all directors without cause, subject to certain limitations designed to protect the rights of class and cumulative voting, California law permits holders of at least 10% of shares of any class to bring a lawsuit to remove a director before his or her term expires for: (1) fraudulent or dishonest acts; or (2) gross abuse of authority or discretion. Such suits must make the corporation a party to the action. *See* Corporations Code §304.

[6] Section 710 applies to any corporation with 100 or more shareholders of record; provided that it does apply to any corporation, if at the time of filing the amendment, the corporation has (i) outstanding shares of more than one class of stock; (ii) no class of equity securities registered under Section 12(b) or 12(g) of the Securities Exchange Act of 1934; and (iii) has fewer than 300 shareholders of record. The Corporations Committee of the Business Law Section of the State Bar of California expects to introduce a bill in the 2005/2006 session of the California legislature to amend Section 710 to eliminate the two-year sunset provision on supermajority voting provisions.

corporation or its subsidiary (subject to certain exclusions, such as the repurchase of stock held by employees). The consequence of this broad definition is that dividends, stock repurchases, and stock redemptions are all subject to the same tests and restrictions. Unlike Delaware law, which generally permits companies to pay dividends or make redemptions as long as the Corporation is solvent following the transaction, California law prohibits such payments unless the Corporation meets certain mechanical financial tests.[7] *As a result, quasi-California corporations may be precluded by California law from making a required dividend or redemption payment, even though such a payment would be permissible under Delaware law. Under Corporations Code Section 316(a)(1), also applicable to quasi-California corporations, directors are liable to the corporation for illegal distributions if they acted willfully or negligently with respect to such distributions.*

Indemnification; Exculpation. The limitations on director and officer indemnification under Section 317 of the Corporations Code are also applicable to a quasi-California corporation. While California and Delaware law both generally permit provisions eliminating or limiting the personal liability of directors for monetary damages, California law is somewhat more restrictive in scope and does not permit directors to be exonerated for actions or omissions that constitute a "reckless disregard" for or "an unexcused pattern of inaction that amounts to an abdication" of a director's duty to the corporation or its shareholders. Counsel may want to tailor indemnification provisions to reflect California law so that all parties have consistent expectations with regard to indemnification of officers and directors.

Mergers and Reorganizations. Sections 1001 and 1101 and Chapter 12 and 13 of the Corporations Code also apply to quasi-California corporations. These sections deal with mergers, reorganizations, and asset sales, including voting rights and the application of California dissenters' rights. California may require class votes on sale transactions, so parties should consider whether additional voting agreements are appropriate to secure a possible common stock class vote in such a transaction. Additionally, in contrast to Delaware law, California law will grant dissenters' rights in connection with the sale of assets in exchange for stock of an acquiring Corporation. Furthermore, California law will require a fairness opinion in connection with certain interested party transactions, so the parties should take particular care if a merger, reorganization or asset sale involves a potentially interested party.

Inspection. Under California law, directors have an absolute right[8] *to inspect any of the books and records of a California or quasi-California corporation and certain shareholders have an*

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[7] Corporations Code § 500 prohibits distributions to shareholders unless: (1) the amount of retained earnings of the corporation immediately before distribution equals or exceeds the amount of the proposed distribution, OR (2) if immediately after the distribution (a) the sum of the corporation's assets (as adjusted) would be at least equal to 125% of its liabilities (as adjusted); AND (b) current assets would be at least equal to current liabilities (or in some circumstances at least equal to 125% of current liabilities).

[8] Section 1602 of the Corporations Code provides, in part, "Every director shall have the absolute right at any reasonable time to inspect and copy all books, records and documents of every kind and to inspect the physical properties of the corporation of which such person is a director . . ."

absolute right to obtain the shareholder list of a California or quasi-California corporation.[9] *In contrast, Section 220 of the DGCL conditions these rights upon demonstration of a proper purpose.*

b. Conclusion.

While Delaware remains the preferred jurisdiction for incorporation of venture-backed companies, California provides a viable alternative jurisdiction particularly when the Corporation will be based and operated predominantly in California and is unlikely to go public. Likewise, existing California corporations who seek venture financing may desire to remain California corporations rather than reincorporating in Delaware.

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[9] Shareholders who either individually or in aggregate hold 5% of voting shares (or 1% if they file a Schedule 14A with the SEC) have an absolute right to inspect and copy the shareholder list on 5 business days' notice or obtain a copy of the list. All other shareholders have a right to inspect and copy, but only for a purpose reasonably related to their interest as shareholders. Furthermore, shareholders can inspect the books and records of the corporation if it is for a purpose reasonably related to their interest as shareholders. This right applies to California corporations or foreign corporations who have their principal office in California. *See* Corporations Code § 1601. These rights cannot be limited by the Articles of Incorporation. *See* Corporations Code § 1600.

AMENDED AND RESTATED
ARTICLES OF INCORPORATION
OF
[_____]

(Pursuant to Chapter 9 of the
the California Corporations Code)

[Comment: Pursuant to Section 900 of the California Corporations Code (the "Corporations Code"), a California corporation "may amend its Articles of Incorporation, from time to time, in any and as many respects as may be desired, so long as its Articles of Incorporation as amended would contain only such provisions as it would be lawful and proper to insert in original Articles of Incorporation filed at the time of the filing of the amendment." Sections 902 through 910 set forth the specific requirements that must be followed to properly effect the amendment.]

[_____] and [_____] certify that:

1. They are the [president, vice president, or chairman of the board of directors], and the [secretary, chief financial officer, treasurer, assistant secretary, or assistant treasurer] of [name of this corporation], a California corporation.

2. The Articles of Incorporation of this corporation, as amended to the date of the filing of this certificate, including amendments set forth herein in but not separately filed (and with the omissions required by Section 910 of the California Corporations Code (the "Corporations Code"), are restated to read in full as follows:

[Comment: Section 910 of the Corporations Code permits a corporation to restate in a single certificate the entire text of its articles of incorporation as amended by filing an officers' certificate or, in the circumstances where the incorporators or the board of directors have the authority to amend the articles of incorporation, a certificate signed and verified by a majority of the incorporators or the board.]

FIRST: The name of this corporation is [_____] (the "**Corporation**")

SECOND: The purpose of the Corporation is to engage in any lawful act or activity for which a corporation may be organized under the General Corporation Law of California (the "General Corporation Law") other than the banking business, the trust company business, or the practice of a profession permitted to be incorporated by the Corporations Code.

THIRD: [The name [and address] in the State of California of the Corporation's initial agent for service of process is [name] and [address]. [10]

FOURTH: This Corporation is authorized to issue two classes of stock designated, respectively, "**Common Stock**" and "**Preferred Stock**. " The number of shares of Common Stock this Corporation is authorized to issue is [_____], and the number of shares of Preferred Stock this Corporation is authorized to issue is [_____].

[Comment: The number of authorized shares of Common Stock should be high enough to cover all outstanding shares of Common Stock, plus all shares of Common Stock (i) issuable upon exercise of outstanding options and all other uncommitted shares of stock available for grant under the stock plan pool, (ii) issuable upon the conversion of shares of designated preferred stock, including, if applicable, accrued dividends [and shares issuable as a result of anti-dilution provisions in prior rounds], (iii) issuable upon the exercise or conversion of all other securities exercisable for or convertible into Common Stock (e.g., warrants and convertible promissory notes) and (iv) issuable within a reasonable time frame in respect of any compounding dividend. Consideration should also be given to authorizing additional shares of Common Stock to permit the Board of Directors to issue such stock in connection with future events, such as acquisitions of other companies or businesses or in lending transactions. Note, however, that many venture capital investors will not permit the authorization of significant amounts of (or even any) additional shares of Common Stock.

With respect to the authorized Preferred Stock, the principal question is whether or not shares of undesignated Preferred Stock should be authorized to facilitate "blank check preferred" and/or a "pay-to-play" provision. Section B of this Article Fourth includes a blank check preferred provision with commentary and Section 5A of this Article Fourth includes a pay-to-play provision with commentary.

California law does not recognize any concept of "par value" of shares. Corporations Code §205 provides: "Solely for the purpose of any statute or regulation imposing any tax or fee based upon the capitalization of a corporation all authorized shares of a corporation authorized under this division shall be deemed to have a nominal or par value of one dollar ($1) per share. If any federal or other statute or regulation applicable to a particular corporation requires that the shares of such corporation have a par value, such shares shall

[10] The names and addresses of the first directors and of the initial agent for service of process should be omitted if the Corporation has filed an information statement under Corporations Code § 1502. *See* Corporations Code § 910(a). Do not use post office box; if a corporate agent is designated, do not set forth the address.

have the par value determined by the board in order to satisfy the requirements of such statute or regulation[11]."

The following is a statement of the rights, preferences, privileges and restrictions granted to or imposed upon each class of shares of the capital stock of the Corporation and the holders thereof.[12] Unless otherwise indicated, references to "Sections" or "Subsections" in this Article refer to sections and subsections of this Article Fourth.

A. COMMON STOCK

1. General. The voting, dividend and liquidation rights of the holders of the Common Stock are subject to and qualified by the rights, preferences, privileges and restrictions of the holders of the Preferred Stock set forth herein or determined by resolution of the Board of Directors with respect to any series of Preferred Stock authorized herein.

2. Voting. The holders of the Common Stock are entitled to one vote for each share of Common Stock held at all meetings of shareholders (and written actions in lieu of meetings) [; provided, however, that, except as otherwise required by law, holders of Common Stock, as such, shall not be entitled to vote on any amendment to the Articles of Incorporation that relates solely to the terms of one or more outstanding series of Preferred Stock if the holders of such affected series are entitled, either separately or together with the holders of one or more other such series, to vote thereon pursuant to the Articles of Incorporation or pursuant to the General Corporation Law]. Every shareholder entitled to vote at an election for directors may cumulate such shareholder's votes and give one candidate a number of votes equal to the number of directors to be elected multiplied by the number of votes to which such shareholder's shares are otherwise entitled, or distribute the shareholder's votes on the same principle among as many candidates as such shareholder desires.[13] No shareholder, however, shall be entitled to so cumulate such shareholder's votes unless (i) the names of such candidate or candidates have been placed in nomination prior to the voting and (ii) the shareholder has given notice at the

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[11] By contrast, the decision to select par or no par stock and, if par, what par value, has two consequences for a Delaware corporation. First, it determines the filing fee owed to the State of Delaware upon filing the Articles of Incorporation. Second, in Delaware, the aggregate par value of the outstanding stock is subtracted from the net assets of the corporation in determining the amount of the corporation's funds that are "surplus" lawfully available for the payment of dividends and the repurchase or redemption of stock. *See* DGCL §154 (setting forth how "surplus" is calculated), 170(a) (setting forth the sources of funds from which dividends may lawfully be paid), 160(a) (setting forth the sources of funds from which stock may lawfully be redeemed or repurchased). Both of these consequences counsel in favor of assigning to stock a low par value (but not no par value).

[12] Note that if the Articles of Incorporation authorize "blank check" preferred stock as discussed in Article Four, Section B.2, the rights, preferences and privileges of the preferred stock could be set forth in a separate certificate of determination.

[13] The cumulative voting provisions of Section 708 of the Corporations Code apply equally to any voting Common or Preferred Stock. Since Preferred Stock typically votes on an as converted basis (i.e. the number of Common shares into which the Preferred would be converted), cumulative voting provisions need not be repeated in a separate section for the Preferred.

meeting, prior to the voting, of such shareholder's intention to cumulate such shareholder's votes. If any shareholder has given proper notice to cumulate votes, all shareholders may cumulate their votes for any candidates who have been properly placed in nomination. Under cumulative voting, the candidates receiving the highest number of votes, up to the number of directors to be elected, shall be elected.[14]

[Comment: The proviso in the first sentence is intended to ensure that where an amendment to the Articles of Incorporation (or a certificate of determination created pursuant to the "blank check" authority) affects only a class or series of Preferred Stock, such amendment may be approved by only the holders of the affected class or series of stock, without the necessity of approval by the holders of Common Stock. Section 700(a) of the Corporations Code states that, unless otherwise provided in the Articles of Incorporation, and subject to Section 708 (dealing with cumulative voting) each share of capital stock is entitled to one vote on all matters presented to shareholders for a vote. Any amendment to the Articles of Incorporation must be effected in accordance with the procedure in Section 902 of the Corporations Code, which typically includes the vote of the holders of the Common Stock. Accordingly, it may be desirable to provide in the Articles of Incorporation that only the holders of the affected series of Preferred Stock need vote on an amendment to the terms of such series. This is not a common provision, and adding it to the Articles of Incorporation may require a class vote of the Common Stock under Section 903(a)(4) of the Corporations Code.]

3. [Authorization of Additional Shares. The Corporation shall from time to time, without further approval of the shareholders, increase the authorized number of the shares of its Common Stock if at any time the number of shares of Common Stock remaining unissued and available for issuance shall not be sufficient to permit the conversion of the Preferred Stock or the exercise of options for Common Stock granted by the Corporation.]

[Comment: Note that the preceding provision restates Section 405(a) of the Corporations Code. Under Section 405(b) of the Corporations Code, where a Corporation has by the affirmative vote of a majority of the outstanding shares entitled to vote obtained the approval of the issue of options to purchase shares or of securities convertible into shares, the board of directors without further approval of the shareholders may amend the articles of incorporation to increase the authorized number of shares of any class or series to such number as will be sufficient when added to the previously authorized but unissued shares of such class or series to satisfy any such option or conversion rights. See Corporations Code §903(a) (1); see also 1 Marsh's California Corporation Law §7.09 (4th ed. 2005) (on the advisability of obtaining such a vote).

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[14] California law only permits "listed corporations" to eliminate cumulative voting. *See* Corporations Code § 301.5(a),(f). "Listed corporations" are companies with outstanding securities that are listed on the NYSE, AMSE or NASDAQ. *See* Corporations Code § 301.5(d).

B. PREFERRED STOCK

1. Issuance and Reissuance.

Preferred Stock may be issued from time to time in one or more series, each of such series to consist of such number of shares and to have such rights, preferences, privileges and restrictions as stated or expressed herein [or in the resolution or resolutions providing for the issue of such series adopted by the Board of Directors of the Corporation as hereinafter provided].[15] Any shares of Preferred Stock which may be redeemed, purchased or acquired by the Corporation may be reissued except as otherwise provided by law or by the terms of any series of Preferred Stock.[16]

2. Blank Check Preferred Stock.[17]

[Subject to any vote expressly required by the Articles of Incorporation] [and solely to the extent necessary to effect the provisions of Section C.5A of these Articles of Incorporation], authority is hereby expressly granted to the Board of Directors from time to time to issue the Preferred Stock in one or more series, and in connection with the creation of any such series, by resolution or resolutions to designate and to fix the number of shares of any such series and to determine and fix such voting powers, full or limited, or no voting powers, and such other rights, preferences, privileges, and restrictions of any wholly unissued series, including, without

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[15] Language not needed if no blank check preferred.

[16] *See* Corporations Code §510.

[17] This paragraph grants the Board of Directors authority to create a new series of Preferred Stock and establish the rights and preferences of such series (often referred to as "blank check preferred"). Without this express grant of authority to the Board, the Corporation would need to obtain shareholder approval to amend its Articles of Incorporation to create a new series of Preferred Stock. As noted above in the introductory comments, if the terms of the Series A Preferred Stock include a pay-to-play provision pursuant to which the Series A Preferred Stock of non-participating investors is converted into a shadow series of Series A Preferred Stock, it is generally desirable for the Articles of Incorporation to authorize the Board to issue blank check preferred to facilitate the creation (if necessary) of such shadow series. Venture capital investors often resist the creation of blank check preferred (except as may be necessary to implement a pay-to-play provisions) and, even if blank check preferred is authorized, the provision often includes restrictions on the determination or issuance of blank check preferred.

This form assumes that blank check preferred will be authorized, and accordingly includes, within the Series A Preferred Stock terms, references to other series of Preferred Stock. These references permit the Corporation to create another series of Preferred Stock by means of a Certificate of Determination without having to revise the terms of the Series A Preferred Stock (which can only be done by a Certificate of Amendment, approved by shareholders, and not by a Certificate of Determination). However, it would be very unusual for the Series A Preferred Stock terms to permit the creation (by Certificate of Determination or otherwise) of a new series of Preferred Stock ranking senior to the Series A Preferred Stock with respect to liquidation, dividends or redemption rights without the consent of the holders of Series A Preferred Stock. Accordingly, since a shareholder vote would normally be required to create a series of Preferred Stock senior to the Series A Preferred Stock (which would permit such a senior series to be added to the charter by means of a Certificate of Amendment rather than a Certificate of Determination), and in order to keep the Series A Preferred Stock terms a little simpler than they might otherwise be, the references to another series of Preferred Stock do not contemplate a series that is senior to the Series A Preferred Stock.

limitation thereof, dividend rights, special voting rights, conversion rights, redemption privileges and liquidation preferences, as shall be stated and expressed in such resolutions, all to the full extent now or hereafter permitted by the General Corporation Law. Without limiting the generality of the foregoing, and subject to the rights of any series of preferred stock then outstanding, the resolutions providing for issuance of any series of Preferred Stock may provide that such series shall be superior or rank equally or be junior to the Preferred Stock of any other series to the extent permitted by law. The Board of Directors, within the limits stated in any resolution of the Board of Directors originally fixing the number of shares constituting any series, may increase or decrease (but not below the number of shares of such series then outstanding) the number of shares of any series subsequent to the issue of shares of that series.

C. SERIES A PREFERRED STOCK

[_____] shares of the authorized and unissued Preferred Stock of the Corporation are hereby designated "**Series A Preferred Stock**" with the following rights, preferences, privileges and restrictions.

1. Dividends.

[Use the following paragraph if the Term Sheet calls for no specific dividend on the Series A Preferred Stock, but an equal sharing if dividends are declared on the Common Stock.]

The Corporation shall not declare, pay or set aside any dividends on shares of any other class or series of capital stock of the Corporation (other than dividends on shares of Common Stock payable in shares of Common Stock)[18] unless (in addition to the obtaining of any consents required elsewhere in the Articles of Incorporation) the holders of the Series A Preferred Stock then outstanding shall first receive, or simultaneously receive, a dividend on each outstanding share of Series A Preferred Stock in an amount at least equal to: (i) in the case of a dividend on Common Stock or any class or series that is convertible into Common Stock, that dividend per share of Series A Preferred Stock as would equal the product of (A) the dividend payable on each share of such class or series determined, if applicable, as if all shares of such class or series had been converted into Common Stock and (B) the number of shares of Common Stock issuable upon conversion of a share of Series A Preferred Stock, in each case calculated on the record date for determination of holders entitled to receive such dividend or (ii) in the case of a dividend on any class or series that is not convertible into Common Stock, at a rate per share of Series A Preferred Stock determined by (A) dividing the amount of the dividend payable on each share of such class or series of capital stock by the original issuance price of such class or series of capital stock (subject to appropriate adjustment in the event of any stock dividend, stock split, combination or other similar recapitalization affecting such shares) and (B)multiplying such fraction by an amount equal to the Series A Original Issue Price (as defined below); provided

[18] These dividends are excluded (as are the comparable dividends in the alternative dividend provision that follows) because they are addressed by subsection 4(d) of this Section C which adjust the Series A Conversion Price in the event of such a dividend.

that, if the Corporation declares, pays or sets aside, on the same date, a dividend on shares of more than one class or series of capital stock of the Corporation, the dividend payable to the holders of Series A Preferred Stock pursuant to this Section 1 shall be calculated based upon the dividend on the class or series of capital stock that would result in the highest Series A Preferred Stock dividend. The "**Series A Original Issue Price**" shall mean $[___][19] per share, subject to appropriate adjustment in the event of any stock dividend, stock split, combination or other similar recapitalization with respect to the Series A Preferred Stock.

[Use the following paragraph if the Term Sheet calls for a specified cumulative dividend, payable if and when declared by the Board.]

From and after the date of the issuance of any shares of Series A Preferred Stock, dividends at the rate per annum of $[___] per share[20] shall accrue on such shares of Series A Preferred Stock (subject to appropriate adjustment in the event of any stock dividend, stock split, combination or other similar recapitalization affecting such shares) (the "**Accruing Dividends**"). Accruing Dividends shall accrue from day to day, whether or not declared, and shall be cumulative; provided however, that except as set forth in the following sentence of this paragraph (a) or in Subsections 2(a) and 6, the Corporation shall be under no obligation to pay such Accruing Dividends. [In the event that any shares of Series A Preferred Stock convert into New Preferred Stock pursuant to Section 5A, the Accruing Dividends accrued on such shares through the date of such conversion shall carry forward and continue as accrued dividends on the shares of such New Preferred Stock.][21] The Corporation shall not declare, pay or set aside any dividends on shares of any other class or series of capital stock of the Corporation (other than dividends on shares of Common Stock payable in shares of Common Stock) unless (in addition to the obtaining of any consents required elsewhere in the Articles of Incorporation) the holders of the Series A Preferred Stock then outstanding shall first receive, or simultaneously receive, a dividend on each outstanding share of Series A Preferred Stock in an amount at least equal to the greater of[22] (i) the amount of the aggregate Accruing Dividends then accrued on such share of

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[19] Insert initial Series A purchase price.

[20] A cumulative dividend expressed as "$____ per share" will by definition be non-compounding. If a compounding accrued dividend is desired, it should be expressed as a percentage of a "base amount", with the "base amount" defined as the original purchase price plus the amount of previously accrued dividends (it should also be specified whether this "compounding" of the original purchase price is done on an annual, quarterly, etc. basis).

[21] Include this sentence only if the pay-to-play provision providing for conversion of Series A Preferred Stock into a shadow series of Preferred Stock is included in these Articles of Incorporation.

[22] An alternative approach to this provision would be to provide that, if a dividend is paid on another class or series of stock, the holders of Series A Preferred Stock receive a dividend equal to their accrued dividend plus the equivalent to the dividend paid on the other class or series of stock. (However, such an approach may not be sensible with respect to dividends paid on another series of Preferred Stock, particularly one which contains a reciprocal dividend provision, as it may result in an endless series of payments as any payment with respect to one series would trigger a payment with respect to the other). This provision (and the similar provision in the first alternative dividend paragraph) are likely to be of little practical import, as most venture capital-backed companies do not have the cash flow to make any dividend payments, and the negative covenants (contained in Section 3(c) prohibit dividend payments without the consent of some percentage of the holders of Series A Preferred Stock.

Series A Preferred Stock and not previously paid and (ii) (A) in the case of a dividend on Common Stock or any class or series that is convertible into Common Stock, that dividend per share of Series A Preferred Stock as would equal the product of (1) the dividend payable on each share of such class or series determined, if applicable, as if all shares of such class or series had been converted into Common Stock and (2) the number of shares of Common Stock issuable upon conversion of a share of Series A Preferred Stock, in each case calculated on the record date for determination of holders entitled to receive such dividend or (B) in the case of a dividend on any class or series that is not convertible into Common Stock, at a rate per share of Series A Preferred Stock determined by (1) dividing the amount of the dividend payable on each share of such class or series of capital stock by the original issuance price of such class or series of capital stock (subject to appropriate adjustment in the event of any stock dividend, stock split, combination or other similar recapitalization affecting such shares) and (2) multiplying such fraction by an amount equal to the Series A Original Issue Price (as defined below); provided that, if the Corporation declares, pays or sets aside, on the same date, a dividend on shares of more than one class or series of capital stock of the Corporation, the dividend payable to the holders of Series A Preferred Stock pursuant to this paragraph (a) shall be calculated based upon the dividend on the class or series of capital stock that would result in the highest Series A Preferred Stock dividend. The "**Series A Original Issue Price**" shall mean $[___][23] per share, subject to appropriate adjustment in the event of any stock dividend, stock split, combination or other similar recapitalization with respect to the Series A Preferred Stock.

[Use the following paragraph if the Term Sheet calls for a specified non-cumulative dividend payable when and if declared by the Board.]

The Corporation shall not declare, pay or set aside any dividends on shares of any other class or series of capital stock of the Corporation (other than dividends on shares of Common Stock payable in shares of Common Stock) unless (in addition to the obtaining of any consents required elsewhere in the Articles of Incorporation) the holders of the Series A Preferred Stock then outstanding shall first receive, or simultaneously receive, a dividend on each outstanding share of Series A Preferred Stock in an amount at least equal to the greater of (i) $[___] per share of Series A Preferred Stock (subject to appropriate adjustment in the event of any stock dividend, stock split, combination or other similar recapitalization affecting such shares) per year from and after the date of the issuance of any shares of Series A Preferred Stock (to the extent not previously paid) and (ii) (A) in the case of a dividend on Common Stock or any class or series that is convertible into Common Stock, that dividend per share of Series A Preferred Stock as would equal the product of (1) the dividend payable on each share of such class or series determined, if applicable, as if all shares of such class or series had been converted into Common Stock and (2) the number of shares of Common Stock issuable upon conversion of a share of Series A Preferred Stock, in each case calculated on the record date for determination of holders entitled to receive such dividend or (B) in the case of a dividend on any class or series that is not convertible into Common Stock, at a rate per share of Series A Preferred Stock determined by (1) dividing the amount of the dividend payable on each share of such class or series of capital

[23] Insert initial Series A purchase price.

stock by the original issuance price of such class or series of capital stock (subject to appropriate adjustment in the event of any stock dividend, stock split, combination or other similar recapitalization affecting such shares) and (2) multiplying such fraction by an amount equal to the Series A Original Issue Price (as defined below); provided that, if the Corporation declares, pays or sets aside, on the same date, a dividend on shares of more than one class or series of capital stock of the Corporation, the dividend payable to the holders of Series A Preferred Stock pursuant to this paragraph (a) shall be calculated based upon the dividend on the class or series of capital stock that would result in the highest Series A Preferred Stock dividend. The foregoing dividend shall not be cumulative. The "**Series A Original Issue Price**" shall mean $[___][24] per share, subject to appropriate adjustment in the event of any stock dividend, stock split, combination or other similar recapitalization with respect to the Series A Preferred Stock.

2. Liquidation, Dissolution or Winding Up; Certain Mergers, Consolidations and Asset Sales.

[Use the following clauses (a) and (b) if the term sheet calls for non-participating Preferred Stock.]

(a) Payments to Holders of Series A Preferred Stock. In the event of any voluntary or involuntary liquidation, dissolution or winding up of the Corporation, the holders of shares of Series A Preferred Stock then outstanding shall be entitled to be paid out of the assets of the Corporation available for distribution to its shareholders [(on a pari passu basis with the holders of any series of Preferred Stock ranking on liquidation on a parity with the Series A Preferred Stock), and][25] before any payment shall be made to the holders of Common Stock [or any other class or series of capital stock ranking on liquidation junior to the Series A Preferred Stock][26] by reason of their ownership thereof, an amount per share equal to the greater of (i) [__ times] the Series A Original Issue Price, plus any dividends declared but unpaid thereon,[27] or (ii) such amount per share as would have been payable had each such share been converted into Common Stock pursuant to Section 4 immediately prior to such liquidation, dissolution or winding up (the amount payable pursuant to this sentence is hereinafter referred to as the "**Series A Liquidation Amount**").[28] If upon any such liquidation, dissolution or winding up of the

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[24] Insert initial Series A purchase price.

[25] Language not needed if no blank check preferred.

[26] Language not needed if no blank check preferred.

[27] If cumulative dividends are specified, the following language would generally be used instead: "the Series A Original Issue Price, plus any Accruing Dividends accrued but unpaid thereon, whether or not declared, together with any other dividends declared but unpaid thereon"

[28] If this form is being modified to add Series B Preferred Stock as part of these Preferred Stock terms, the calculation of the Series A Liquidation Amount and the Series B Liquidation Amount becomes quite complicated, for the following reason. In determining whether the payment to the holders of any particular series of Preferred Stock would be maximized by the conversion of those shares into Common Stock, it is necessary to make an assumption as to which shares of Preferred Stock have converted into Common Stock. To restate this point, determining the amount provided for in clause (ii) of this sentence for any particular series of Preferred Stock

Corporation, the assets of the Corporation available for distribution to its shareholders shall be insufficient to pay the holders of shares of Series A Preferred Stock [and any series of Preferred Stock ranking on liquidation on a parity with the Series A Preferred Stock][29] the full amount to which they shall be entitled under this Subsection 2(a), the holders of shares of Series A Preferred Stock [and any series of Preferred Stock ranking on liquidation on a parity with the Series A Preferred Stock][30] shall share ratably in any distribution of the assets available for distribution in proportion to the respective amounts which would otherwise be payable in respect of the shares held by them upon such distribution if all amounts payable on or with respect to such shares were paid in full.[31]

(b) Payments to Holders of Common Stock. In the event of any voluntary or involuntary liquidation, dissolution or winding up of the Corporation, after the payment of all preferential amounts required to be paid to the holders of shares of Series A Preferred Stock [and any other series of Preferred Stock of the Corporation ranking on liquidation senior to the Common Stock],[32] the remaining assets of the Corporation available for distribution to its

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requires you to calculate the Liquidation Amount for each other series of Preferred Stock (so you can calculate the amount available for distribution to the holders of Common Stock and the series of Preferred Stock in question); and calculating the Liquidation Amount for each such other series itself involves a determination of whether the original purchase price for such other series of Preferred Stock exceeds the amount payable with respect to such series on an as-converted basis – and this latter amount cannot be calculated without knowing what the Liquidation Amounts are for all other series of Preferred Stock. If the various series of Preferred Stock are not pari passu, these calculations become even more difficult. The most logical approach is to assume the conversion into Common Stock of all shares of each series of Preferred Stock that would receive a greater per share liquidation payment if converted into Common Stock than if remaining as Preferred Stock, and to provide (in the version of the charter incorporating the Series B Preferred Stock terms) that this assumption shall apply in making the calculation required by this sentence.

Some versions of Preferred Stock terms simply state that the liquidation payment to be made to a particular series of Preferred Stock is equal to the original purchase price of such Preferred Stock, plus accrued or declared dividends, rather than the higher of such amount and the as-converted payment. That alternative formulation is not intended to result in a substantive difference from the approach taken in this form; rather, in that alternative formulation, it is assumed that the holders of a particular series of Preferred Stock would simply convert into Common Stock if the as-converted payment is greater than the original purchase price plus dividends. While such alternative formulation avoids the drafting complexities described in the preceding paragraph, it simply shifts those complexities to the decision each individual holder of Preferred Stock must make at the time of a liquidation event. That is, each Preferred Shareholder must decide whether it will receive a higher payment if it converts into Common Stock; and such determination would require each Preferred Shareholder to make an assumption as to whether the other holders of Preferred Stock (both of the same series and of different series) will convert into Common Stock.

This issue is not applicable to participating Preferred Stock – because participating Preferred Stock entitles its holder to receive both the basic liquidation payment and the as-converted payment, there is no need to determine whether the basic payment or the as-converted payment is greater.

[29] Language not needed if no blank check preferred.

[30] Language not needed if no blank check preferred.

[31] In the event that the Preferred Stock is redeemable at a premium to the purchase price, it may be advisable to restructure this section so that the stock may not be deemed "preferred stock" within the meaning of applicable US Treasury regulations. *See* footnotes 63 and 94.

[32] Language not needed if no blank check preferred.

shareholders shall be distributed among the holders of shares of Common Stock, pro rata based on the number of shares held by each such holder.

[Use the following clause (a) and (b) if the term sheet calls for participating Preferred Stock.]

(a) Preferential Payments to Holders of Series A Preferred Stock. In the event of any voluntary or involuntary liquidation, dissolution or winding up of the Corporation, the holders of shares of Series A Preferred Stock then outstanding shall be entitled to be paid out of the assets of the Corporation available for distribution to its shareholders [(on a pari passu basis with the holders of any series of Preferred Stock ranking on liquidation on a parity with the Series A Preferred Stock), and][33] before any payment shall be made to the holders of Common Stock [or any other class or series of capital stock ranking on liquidation junior to the Series A Preferred Stock][34] by reason of their ownership thereof, an amount per share equal to [__ times] the Series A Original Issue Price, plus any dividends declared but unpaid thereon.[35] If upon any such liquidation, dissolution or winding up of the Corporation, the assets of the Corporation available for distribution to its shareholders shall be insufficient to pay the holders of shares of Series A Preferred Stock [and any other series of Preferred Stock ranking on liquidation on a parity with the Series A Preferred Stock] the full amount to which they shall be entitled under this Subsection 2(a), the holders of shares of Series A Preferred Stock [and any other series of Preferred Stock ranking on liquidation on a parity with the Series A Preferred Stock] shall share ratably in any distribution of the remaining assets available for distribution in proportion to the respective amounts which would otherwise be payable in respect of the shares held by them upon such distribution if all amounts payable on or with respect to such shares were paid in full.

(b) Distribution of Remaining Assets. In the event of any voluntary or involuntary liquidation, dissolution or winding up of the Corporation, after the payment of all preferential amounts required to be paid to the holders of shares of Series A Preferred Stock [and any other series of Preferred Stock of the Corporation ranking on liquidation senior to the Common Stock][36], the remaining assets of the Corporation available for distribution to its shareholders shall be distributed among the holders of the shares of Series A Preferred Stock [, any other series of Preferred Stock entitled pursuant to the terms of the Articles of Incorporation to participate with the Common Stock in the distribution of such remaining assets][37] and Common Stock, pro rata based on the number of shares held by each such holder, treating for this purpose all such securities as if they had been converted to Common Stock pursuant to the terms of the

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[33] Language not needed if no blank check preferred.

[34] Language not needed if no blank check preferred.

[35] Modify if alternative dividend provisions are selected.

[36] Language not needed if no blank check preferred.

[37] Language not needed if no blank check preferred.

Articles of Incorporation immediately prior to such dissolution, liquidation or winding up of the Corporation.[38] The aggregate amount which a holder of a share of Series A Preferred Stock is entitled to receive under Subsections 2(a) and 2(b) is hereinafter referred to as the "**Series A Liquidation Amount**."

(c) Deemed Liquidation Events.[39]

(i) Each of the following events shall be considered a "**Deemed Liquidation Event**", unless the holders of at least *[specify percentage[40]]* of the outstanding shares of Series A Preferred Stock elect otherwise by written notice sent to the Corporation at least [__] days prior to the effective date of any such event:

(A) a merger or consolidation[41] in which

(I) the Corporation is a constituent party or

(II) a subsidiary of the Corporation is a constituent party and the Corporation issues shares of its capital stock pursuant to such merger or consolidation,

except any such merger or consolidation involving the Corporation or a subsidiary in which the shares of capital stock of the Corporation outstanding immediately prior to such merger or consolidation continue to represent, or are converted into or exchanged for shares of capital stock

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[38] If a cap to the liquidation preference is specified in the term sheet, add the following language at the end of this sentence: "; provided, however, that if the aggregate amount which the holders of Series A Preferred Stock are entitled to receive under Subsections 2(a) and 2(b) shall exceed [$_____] per share (subject to appropriate adjustment in the event of a stock split, stock dividend, combination, reclassification, or similar event affecting the Series A Preferred Stock) (the "Maximum Participation Amount"), each holder of Series A Preferred Stock shall be entitled to receive upon such dissolution, liquidation or winding up of the Corporation the greater of (i) the Maximum Participation Amount and (ii) the amount such holder would have received if such holder had converted his, her or its shares of Series A Preferred Stock into Common Stock immediately prior to such dissolution, liquidation or winding up of the Corporation."

[39] It is generally unadvisable to insert language which includes a change of control transaction as a Deemed Liquidation Event, as such transactions may not be within the control of the Corporation and, in any event, could be inadvertently triggered with unintended consequences. A better practice is to protect against such events through a combination of other measures, including protective provisions regarding the issuance of stock and rights of first refusal over transfers of stock by other shareholders. Counsel should be aware, however, that protective provisions and rights of first refusal may not be sufficient to protect against all eventualities, particularly given that many venture capital investors refuse to subject their own shares to transfer restrictions such as a right of first refusal.

[40] As discussed in the introductory commentary to this form, Corporations Code § 710 bars super-majority voting requirements in excess of 66 2/3 % for most public and many private California corporations.

[41] If the Corporation were incorporated in a state whose corporate statute provides for statutory share exchanges (California currently does not), a share exchange transaction should be referenced (along with a merger or consolidation) in subsection 2(c)(i)(A), as well as in subsection 2(c)(ii) below.

that represent, immediately following such merger or consolidation, at least a majority, by voting power, of the capital stock of (1) the surviving or resulting corporation or (2) if the surviving or resulting corporation is a wholly owned subsidiary of another corporation immediately following such merger or consolidation, the parent corporation of such surviving or resulting corporation (provided that, for the purpose of this Subsection 2(c)(i), all shares of Common Stock issuable upon exercise of Options (as defined below) outstanding immediately prior to such merger or consolidation or upon conversion of Convertible Securities (as defined below) outstanding immediately prior to such merger or consolidation shall be deemed to be outstanding immediately prior to such merger or consolidation and, if applicable, converted or exchanged in such merger or consolidation on the same terms as the actual outstanding shares of Common Stock are converted or exchanged); or

(B) the sale, lease, transfer, exclusive license or other disposition, in a single transaction or series of related transactions, by the Corporation or any subsidiary of the Corporation of all or substantially all the assets of the Corporation and its subsidiaries taken as a whole [(including, without limitation, [_____])],[42] or the sale or disposition (whether by merger, consolidation or otherwise) of one or more subsidiaries of the Corporation if substantially all of the assets of the Corporation and its subsidiaries taken as a whole are held by such subsidiary or subsidiaries, except where such sale, lease, transfer, exclusive license or other disposition is to a wholly owned subsidiary of the Corporation.

(ii) Effecting a Deemed Liquidation Event.

(A) The Corporation shall not have the power to effect a Deemed Liquidation Event referred to in Subsection 2(c)(i)(A)(I) above unless the agreement or plan of merger or consolidation provides that the consideration payable to the shareholders of the Corporation shall be allocated among the holders of capital stock of the Corporation in accordance with Subsections 2(a) and 2(b) above.

(B) In the event of a Deemed Liquidation Event referred to in Subsection 2(c)(i)(A)(II) or (B) above, if the Corporation does not effect a dissolution of the Corporation under the General Corporation Law within 90 days after such Deemed Liquidation Event, then (A) the Corporation shall send a written notice to each holder of Series A Preferred Stock no later than the 90th day after the Deemed Liquidation Event advising such holders of their right (and the requirements to be met to secure such right) pursuant to the terms of the following clause (B) to require the redemption of such shares of Series A Preferred Stock, and (B) if the holders of at least [*specify percentage*][43] of the then outstanding shares of Series A Preferred Stock so request in a written instrument delivered to the Corporation not later than 120 days after such Deemed Liquidation Event, the Corporation shall use the consideration received by the Corporation for such Deemed Liquidation Event (net of any retained liabilities associated

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[42] Occasionally, it may be appropriate to specify important assets of the Corporation.

[43] As discussed in the introductory commentary to this form, Corporations Code § 710 bars super-majority voting requirements in excess of 66 2/3 % for most public and many private California corporations.

with the assets sold or technology licensed, as determined in good faith by the Board of Directors of the Corporation) (the "**Net Proceeds**"), to the extent legally available therefor, on the 150th day after such Deemed Liquidation Event (the "**Liquidation Redemption Date**"), to redeem all outstanding shares of Series A Preferred Stock at a price per share equal to the Series A Liquidation Amount. Notwithstanding the foregoing, in the event of a redemption pursuant to the preceding sentence, if the Net Proceeds are not sufficient to redeem all outstanding shares of Series A Preferred Stock [and any other series of Preferred Stock ranking on redemption on parity with the Series A Preferred Stock that is required to then be redeemed],[44] or if the Corporation does not have sufficient lawfully available funds to effect such redemption, the Corporation shall redeem a pro rata portion of each holder's shares of Series A Preferred Stock [and any such other series of Preferred Stock][45] to the fullest extent of such Net Proceeds or such lawfully available funds, as the case may be based on the respective amounts which would otherwise be payable in respect of the shares to be redeemed if the legally available funds were sufficient to redeem all such shares, and shall redeem the remaining shares to have been redeemed as soon as practicable after the Corporation has funds legally available therefor. The provisions of Subsections 6(b) through 6(e) below shall apply, with such necessary changes in the details thereof as are necessitated by the context, to the redemption of the Series A Preferred Stock pursuant to this Subsection 2(c)(iii).[46] Prior to the distribution or redemption provided for in this Subsection 2(c)(iii), the Corporation shall not expend or dissipate the consideration received for such Deemed Liquidation Event, except to discharge expenses incurred in connection with such Deemed Liquidation Event or in the ordinary course of business.

(iii) Amount Deemed Paid or Distributed. The amount deemed paid or distributed to the holders of capital stock of the Corporation upon any such merger, consolidation, sale, transfer, exclusive license, other disposition or redemption shall be the cash or the value of the property, rights or securities paid or distributed to such holders by the Corporation or the acquiring person, firm or other entity. [The value of such property, rights or securities shall be determined in good faith by the Board of Directors of the Corporation.][47]

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[44] Language not needed if no blank check preferred.

[45] Language not needed if no blank check preferred.

[46] In the event the Series A Preferred Stock is not redeemable, replace this sentence with modified versions of Section 6(b) through 6(e).

[47] Alternative provision: Amount Deemed Paid or Distributed. If the amount deemed paid or distributed under this Subsection 2(c)(iv) is made in property other than in cash, the value of such distribution shall be the fair market value of such property, determined as follows:

(A) For securities not subject to investment letters or other similar restrictions on free marketability,

(1) if traded on a securities exchange or the NASDAQ Stock Market, the value shall be deemed to be the average of the closing prices of the securities on such exchange or market over the thirty-day (30) period ending three (3) days prior to the closing of such transaction;

3. Voting.

(a) General. On any matter presented to the shareholders of the Corporation for their action or consideration at any meeting of shareholders of the Corporation (or by written consent of shareholders in lieu of meeting), each holder of outstanding shares of Series A Preferred Stock shall be entitled to cast the number of votes equal to the number of whole shares of Common Stock into which the shares of Series A Preferred Stock held by such holder are convertible as of the record date for determining shareholders entitled to vote on such matter. Except as provided by law or by the other provisions of the Articles of Incorporation, holders of Series A Preferred Stock shall vote together with the holders of Common Stock[, and with the holders of any other series of Preferred Stock the terms of which so provide,][48] as a single class.

(b) Election of Directors. The holders of record of the shares of Series A Preferred Stock, exclusively and as a separate class, shall be entitled to elect [__] directors of the Corporation (the "**Series A Directors**") and the holders of record of the shares of Common Stock, exclusively and as a separate class, shall be entitled to elect [__] directors of the Corporation.[49] Any director elected as provided in the preceding sentence may be removed without cause by, and only by, the affirmative vote of the holders of the shares of the class or series of capital stock entitled to elect such director or directors, given either at a special meeting of such shareholders duly called for that purpose or pursuant to a written consent of shareholders.[50] The holders of record of the shares of Common Stock and of any other class or series of voting stock (including the Series A Preferred Stock), exclusively and voting together as a single class, shall [, subject to the rights of any additional series of Preferred Stock that may be established from time to time,][51] be entitled to elect the balance of the total number of

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(2) if actively traded over-the-counter, the value shall be deemed to be the average of the closing bid prices over the thirty-day (30) day period ending three (3) days prior to the closing of such transaction; or

(3) if there is no active public market, the value shall be the fair market value thereof, as determined in good faith by the Board of Directors of the Corporation.

(B) The method of valuation of securities subject to investment letters or other similar restrictions on free marketability (other than restrictions arising solely by virtue of a shareholder's status as an affiliate or former affiliate) shall take into account an appropriate discount (as determined in good faith by the Board of Directors of the Corporation) from the market value as determined pursuant to clause (A) above so as to reflect the approximate fair market value thereof.

[48] Language not needed if no blank check preferred.

[49] The size of the Board of Directors is typically fixed in the By-laws (which permits it to be amended without the need for a charter amendment), though it could be fixed here. The Voting Agreement also typically obligates the parties to vote to fix the size of the Board at a specified number of directors.

[50] Note that Corporations Code § 304 permits shareholders holding at least 10% of any class of outstanding shares to initiate suit to have any director removed in case of fraudulent or dishonest acts or gross abuse of authority or discretion.

[51] Language not needed if no blank check preferred.

directors of the Corporation. At any meeting held for the purpose of electing a director, the presence in person or by proxy of the holders of a majority of the outstanding shares of the class or series entitled to elect such director shall constitute a quorum for the purpose of electing such director. A vacancy in any directorship filled by the holders of any class or series shall be filled only by vote or written consent in lieu of a meeting of the holders of such class or series. The rights of cumulative voting set forth in Section A.2 shall apply to the election of directors pursuant to this Subsection 3(b). No director may be removed (unless the entire Board of Directors is removed) when the votes cast against removal, or not consenting in writing to the removal, would be sufficient to elect the director if voted cumulatively at an election at which the same total number of votes were case (or, if the action is taken by written consent, all shares entitled to vote were voted) and the entire number of directors authorized at the time of the director's most recent election were then being elected.[52] [The rights of the holders of the Series A Preferred Stock and the rights of the holders of the Common Stock under the first sentence of this Subsection 3(b) shall terminate on the first date following the Series A Original Issue Date (as defined below) on which there are issued and outstanding less than [_____] shares of Series A Preferred Stock (subject to appropriate adjustment in the event of any stock dividend, stock split, combination or other similar recapitalization affecting such shares).]

(c) Series A Preferred Stock Protective Provisions. At any time when [shares of Series A Preferred Stock] [at least [____] shares of Series A Preferred Stock (subject to appropriate adjustment in the event of any stock dividend, stock split, combination or other similar recapitalization affecting such shares)] are outstanding, the Corporation shall not, either directly or indirectly by amendment, merger, consolidation or otherwise, do any of the following without (in addition to any other vote required by law or the Articles of Incorporation) the written consent or affirmative vote of the holders of at least [*specify percentage*][53] of the then outstanding shares of Series A Preferred Stock, given in writing or by vote at a meeting, consenting or voting (as the case may be) separately as a class:[54]

(i) liquidate, dissolve or wind-up the business[55] and affairs of the Corporation, effect any Deemed Liquidation Event, or consent to any of the foregoing;

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[52] See Corporations Code §§ 303(a)(1) and 708.

[53] As discussed in the introductory commentary to this form, Corporations Code § 710 bars super-majority voting requirements in excess of 66 2/3 % for most public and many private California corporations.

[54] Consider including here some or all of the additional restrictions in the negative covenants section of the model Investor Rights Agreement. Bear in mind that if the matter may be waived by a vote of a specified portion of the Board, any investor-designated director will be constrained by his or her fiduciary duties to the Corporation. Also, an act by the Corporation in contravention of the Articles of Incorporation generally would be void or voidable.

[55] Under Corporations Code §402.5(b), the percentage of the vote of any class or series of preferred shares required to approve the dissolution of a corporation may not exceed 66 2/3%.

(ii) amend, alter or repeal any provision of the Articles of Incorporation or Bylaws of the Corporation [in a manner that adversely affects the power, preferences or rights of the Series A Preferred Stock];[56]

(iii) create, or authorize the creation of, [or issue or obligate itself to issue shares of,] any additional class or series of capital stock [unless the same ranks junior to [, or if such creation is pursuant to Section 5A, on a parity with,] the Series A Preferred Stock with respect to the distribution of assets on the liquidation, dissolution or winding up of the Corporation, the payment of dividends and redemption rights], or increase the authorized number of shares of Series A Preferred Stock or increase the authorized number of shares of any additional class or series of shares of capital stock [unless the same ranks junior to [, or if such creation is pursuant to Section 5A, on a parity with,] the Series A Preferred Stock with respect to the distribution of assets on the liquidation, dissolution or winding up of the Corporation, the payment of dividends and redemption rights];

(iv) purchase or redeem (or permit any subsidiary to purchase or redeem) or pay or declare any dividend or make any distribution on, any shares of capital stock of the Corporation other than (a) redemptions of or dividends or distributions on the Series A Preferred Stock [or New Preferred Stock][57] as expressly authorized herein, (b) dividends or other distributions payable on the Common Stock solely in the form of additional shares of Common Stock and (c) repurchases of stock from former employees, officers, directors, consultants or other persons who performed services for the Corporation or any subsidiary in connection with the cessation of such employment or service at the lower of the original purchase price or the then-current fair market value thereof [or (d) as approved by the Board of Directors, including the approval of at least one Series A Director];

(v) create, or authorize the creation of, or issue, or authorize the issuance of any debt security, or permit any subsidiary to take any such action with respect to any debt security [,if the aggregate indebtedness of the Corporation and its subsidiaries for borrowed money following such action would exceed $_____] [other than equipment leases or bank lines of credit] unless such debt security has received the prior approval of the Board of Directors; including [the Series A directors] [at least one Series A director][58] [or]

[(vi) create, or hold capital stock in, any subsidiary that is not wholly owned (either directly or through one or more other subsidiaries) by the Corporation, or sell,

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[56] Corporations Code §903 specifies those amendments of the Articles of Incorporation that must be approved by the majority of the outstanding shares of a class.

[57] Include this sentence only if the pay-to-play provision providing for conversion of Series A Preferred Stock into a shadow series of Preferred Stock is included in these Articles of Incorporation.

[58] Despite what practitioners report is the general position of Staff Counsel in the Business Programs Division of the Office of the California Secretary of State (the "Secretary of State's Office") that the Articles may not make corporate action subject to the approval of one or more specified directors**,** according to practitioners, Staff Counsel in the Secretary of State's Office does permit the Articles to require the consent of one or more specified directors where this is in lieu of a vote of the series or class of the shareholders that elected them. *Cf.* footnote 64.

transfer or otherwise dispose of any capital stock of any direct or indirect subsidiary of the Corporation, or permit any direct or indirect subsidiary to sell, lease, transfer, exclusively license or otherwise dispose (in a single transaction or series of related transactions) all or substantially all of the assets of such subsidiary[.][; or]

[(vii) increase or decrease the authorized number of directors constituting the Board of Directors].[59]

4. Optional Conversion.

The holders of the Series A Preferred Stock shall have conversion rights as follows (the "**Conversion Rights**"):

(a) Right to Convert.

(i) Conversion Ratio. Each share of Series A Preferred Stock shall be convertible, at the option of the holder thereof, at any time and from time to time, and without the payment of additional consideration by the holder thereof, into such number of fully paid and nonassessable shares of Common Stock as is determined by dividing the Series A Original Issue Price by the Series A Conversion Price (as defined below) in effect at the time of conversion. The "**Series A Conversion Price**" shall initially be equal to [*insert original purchase price of Series Preferred Stock*].[60] Such initial Series A Conversion Price, and the rate at which shares of Series A Preferred Stock may be converted into shares of Common Stock, shall be subject to adjustment as provided below.

(ii) Termination of Conversion Rights. In the event of a notice of redemption of any shares of Series A Preferred Stock pursuant to Section 6 hereof, the Conversion Rights of the shares designated for redemption shall terminate at the close of business on the last full day preceding the date fixed for redemption, unless the redemption price is not fully paid on such redemption date, in which case the Conversion Rights for such shares shall continue until such price is paid in full.[61] In the event of a liquidation, dissolution or winding up of the Corporation or a Deemed Liquidation Event, the Conversion Rights shall terminate at the close of business on the last full day preceding the date fixed for the payment of any such amounts distributable on such event to the holders of Series A Preferred Stock.

(b) Fractional Shares. No fractional shares of Common Stock shall be issued upon conversion of the Series A Preferred Stock. In lieu of any fractional shares to which the holder would otherwise be entitled, the Corporation shall pay cash equal to such fraction

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[59] This provision often is addressed in the Voting Agreement rather than in the Articles of Incorporation.

[60] Remember in future rounds to substitute a different number, if there have been adjustments to the Series A Conversion Price, and provide for additional adjustments based only on events from that date forward.

[61] Remove this sentence if the Series A Preferred Stock is not redeemable.

multiplied by the fair market value of a share of Common Stock as determined in good faith by the Board of Directors of the Corporation. Whether or not fractional shares would be issuable upon such conversion shall be determined on the basis of the total number of shares of Series A Preferred Stock the holder is at the time converting into Common Stock and the aggregate number of shares of Common Stock issuable upon such conversion.

(c) Mechanics of Conversion.

(i) Notice of Conversion. In order for a holder of Series A Preferred Stock to voluntarily convert shares of Series A Preferred Stock into shares of Common Stock, such holder shall surrender the certificate or certificates for such shares of Series A Preferred Stock (or, if such registered holder alleges that such certificate has been lost, stolen or destroyed, a lost certificate affidavit and agreement reasonably acceptable to the Corporation to indemnify the Corporation against any claim that may be made against the Corporation on account of the alleged loss, theft or destruction of such certificate), at the office of the transfer agent for the Series A Preferred Stock (or at the principal office of the Corporation if the Corporation serves as its own transfer agent), together with written notice that such holder elects to convert all or any number of the shares of the Series A Preferred Stock represented by such certificate or certificates and, if applicable, any event on which such conversion is contingent. Such notice shall state such holder's name or the names of the nominees in which such holder wishes the certificate or certificates for shares of Common Stock to be issued. If required by the Corporation, certificates surrendered for conversion shall be endorsed or accompanied by a written instrument or instruments of transfer, in form satisfactory to the Corporation, duly executed by the registered holder or his, her or its attorney duly authorized in writing. The close of business on the date of receipt by the transfer agent (or by the Corporation if the Corporation serves as its own transfer agent) of such certificates (or lost certificate affidavit and agreement) and notice shall be the time of conversion (the "**Conversion Time**"), and the shares of Common Stock issuable upon conversion of the shares represented by such certificate shall be deemed to be outstanding of record as of such date. The Corporation shall, as soon as practicable after the Conversion Time, issue and deliver to such holder of Series A Preferred Stock, or to his, her or its nominees, a certificate or certificates for the number of full shares of Common Stock issuable upon such conversion in accordance with the provisions hereof, a certificate for the number (if any) of the shares of Series A Preferred Stock represented by the surrendered certificate that were not converted into Common Stock, and cash as provided in Subsection 4(b) in lieu of any fraction of a share of Common Stock otherwise issuable upon such conversion and payment of any declared but unpaid dividends [(but not any undeclared Accruing Dividends)][62] on the shares of Series A Preferred Stock converted.

(ii) Reservation of Shares. The Corporation shall at all times when the Series A Preferred Stock shall be outstanding, reserve and keep available out of its authorized but unissued capital stock, for the purpose of effecting the conversion of the Series A Preferred Stock, such number of its duly authorized shares of Common Stock as shall from time to time be sufficient to effect the conversion of all outstanding Series A Preferred Stock; and if at any time

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[62] Include if there are accruing dividends on the Series A Preferred Stock.

the number of authorized but unissued shares of Common Stock shall not be sufficient to effect the conversion of all then outstanding shares of the Series A Preferred Stock, the Corporation shall take such corporate action as may be necessary to increase its authorized but unissued shares of Common Stock to such number of shares as shall be sufficient for such purposes, including, without limitation, engaging in best efforts to obtain the requisite shareholder approval of any necessary amendment to the Articles of Incorporation.

(iii) Effect of Conversion. All shares of Series A Preferred Stock which shall have been surrendered for conversion as herein provided shall no longer be deemed to be outstanding and all rights with respect to such shares, including the rights, if any, to receive notices and to vote, shall immediately cease and terminate at the Conversion Time, except only the right of the holders thereof to receive shares of Common Stock in exchange therefor and to receive payment of any dividends declared but unpaid thereon.[63] Any shares of Series A Preferred Stock so converted shall be retired and cancelled and shall not be reissued as shares of such series, and the Corporation (without the need for shareholder action) may from time to time take such appropriate action as may be necessary to reduce the authorized number of shares of Series A Preferred Stock accordingly.

(iv) No Further Adjustment. Upon any such conversion, no adjustment to the Series A Conversion Price shall be made for any declared but unpaid dividends on the Series A Preferred Stock surrendered for conversion or on the Common Stock delivered upon conversion.

(v) Taxes. The Corporation shall pay any and all issue and other similar taxes that may be payable in respect of any issuance or delivery of shares of Common Stock upon conversion of shares of Series A Preferred Stock pursuant to this Section 4. The Corporation shall not, however, be required to pay any tax which may be payable in respect of any transfer involved in the issuance and delivery of shares of Common Stock in a name other than that in which the shares of Series A Preferred Stock so converted were registered, and no such issuance or delivery shall be made unless and until the person or entity requesting such issuance has paid to the Corporation the amount of any such tax or has established, to the satisfaction of the Corporation, that such tax has been paid.

(d) Adjustments to Series A Conversion Price for Diluting Issues.

(i) Special Definitions. For purposes of this Section 4, the following definitions shall apply:

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[63] Some investors will insist that, upon conversion, all declared but unpaid dividends (and, if the Series A Preferred Stock is entitled to cumulative dividends, all accrued dividends, whether or not declared) be paid in additional shares of Common Stock rather than in cash. Assuming that the Series A Preferred Stock is "preferred stock" for purposes of Section 305 of the Internal Revenue Code, the issuance of additional shares of Common Stock in payment of accrued but unpaid dividends will likely be deemed to be a taxable stock dividend to the extent of the Corporation's current and accumulated earnings and profits.

(A) "**Option**" shall mean rights, options or warrants to subscribe for, purchase or otherwise acquire Common Stock or Convertible Securities.

(B) "**Series A Original Issue Date**" shall mean the date on which the first share of Series A Preferred Stock was issued.

(C) "**Convertible Securities**" shall mean any evidences of indebtedness, shares or other securities directly or indirectly convertible into or exchangeable for Common Stock, but excluding Options.

(D) "**Additional Shares of Common Stock**" shall mean all shares of Common Stock issued (or, pursuant to Subsection 4(d)(iii) below, deemed to be issued) by the Corporation after the Series A Original Issue Date, other than the following shares of Common Stock, and shares of Common Stock deemed to be issued pursuant to the following Options and Convertible Securities (collectively "**Exempted Securities**"):

(I) shares of Common Stock, Options or Convertible Securities issued as a dividend or distribution on Series A Preferred Stock;

(II) shares of Common Stock, Options or Convertible Securities issued by reason of a dividend, stock split, split-up or other distribution on shares of Common Stock that is covered by Subsection 4(e) or 4(f) below;

(III) shares of Common Stock or Options issued to employees or directors of, or consultants or advisors to, the Corporation or any of its subsidiaries pursuant to a plan, agreement or arrangement approved by the Board of Directors of the Corporation;[64] [65]

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[64] The Certificate of Incorporation of a Delaware corporation may add "including the Series A Directors" or "including at least one Series A Director." *See* DGCL §141(d). Practitioners report that Staff Counsel in the Secretary of State's Office has taken the position that a provision requiring the consent of the Series A Directors or one Series A Director to corporate action is not permitted by Corporations Code §204(a)(5) and conflicts with Corporations Code § 307(a)(8). As an alternative, under Corporations Code § 204(a)(5), approval of a super-majority of directors may be required by the Articles for most corporate actions or a provision requiring approval of these actions by one of more of the Series A directors may be included in a shareholders' agreement to which the corporation is a party. *Cf.* the protective provisions in Section 5.5 of the model Investors' Rights Agreement. Moreover, to ensure a particular class or series of shareholders are represented, approval of such class or series can be required under Corporations Code §204(a)(5) unless the Series A Directors or at least one Series A Director approves. *See* footnote 58.

[65] Alternative provision: (III) up to [_____] shares of Common Stock (subject to appropriate adjustment in the event of any stock dividend, stock split, combination or other similar recapitalization affecting such shares), issued or deemed issued to employees or directors of, or consultants to, the Corporation or any of its

(IV) shares of Common Stock or Convertible Securities actually issued upon the exercise of Options or shares of Common Stock actually issued upon the conversion or exchange of Convertible Securities, in each case provided such issuance is pursuant to the terms of such Option or Convertible Security[66]; or

(V) [shares of Common Stock, Options or Convertible Securities issued to banks, equipment lessors or other financial institutions, or to real property lessors, pursuant to a debt financing, equipment leasing or real property leasing transaction approved by the Board of Directors of the Corporation.[67]

(ii) No Adjustment of Series A Conversion Price. No adjustment in the Series A Conversion Price shall be made as the result of the issuance or deemed issuance of Additional Shares of Common Stock if the Corporation receives written notice from the holders of at least *[specify percentage[68]]* of the then outstanding shares of Series A Preferred Stock agreeing that no such adjustment shall be made as the result of the issuance or deemed issuance of such Additional Shares of Common Stock.

(iii) Deemed Issue of Additional Shares of Common Stock.

(A) If the Corporation at any time or from time to time after the Series A Original Issue Date shall issue any Options or Convertible Securities (excluding Options or Convertible Securities which are themselves Exempted Securities) or shall fix a

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subsidiaries pursuant to the [_____] Plan of the Corporation, whether issued before or after the Series A Original Issue Date (provided that any Options for such shares that expire or terminate unexercised or any restricted stock repurchased by the Corporation at cost shall not be counted toward such maximum number unless and until such shares are regranted as new stock grants (or as new Options) pursuant to the terms of any such plan, agreement or arrangement).

[66] *See* footnote 63.

[67] An exclusion similar to this provision is relatively common. Examples of other exclusions which may be negotiated include the following: (a) shares of Common Stock, Options or Convertible Securities issued to suppliers or third party service providers in connection with the provision of goods or services pursuant to transactions approved by the Board of Directors; (b) shares of Common Stock, Options or Convertible Securities issued pursuant to the acquisition of another corporation by the Corporation by merger, purchase of substantially all of the assets or other reorganization or to a joint venture agreement, provided, that such issuances are approved by the Board of Directors; and (c) shares of Common Stock, Options or Convertible Securities issued in connection with sponsored research, collaboration, technology license, development, OEM, marketing or other similar agreements or strategic partnerships approved by the Board of Directors.

[68] As discussed in the introductory commentary to this form, Corporations Code § 710 bars super-majority voting requirements in excess of 66 2/3 % for most public and many private California corporations.

record date for the determination of holders of any class of securities entitled to receive any such Options or Convertible Securities, then the maximum number of shares of Common Stock (as set forth in the instrument relating thereto, assuming the satisfaction of any conditions to exercisability, convertibility or exchangeability but without regard to any provision contained therein for a subsequent adjustment of such number) issuable upon the exercise of such Options or, in the case of Convertible Securities and Options therefor, the conversion or exchange of such Convertible Securities, shall be deemed to be Additional Shares of Common Stock issued as of the time of such issue or, in case such a record date shall have been fixed, as of the close of business on such record date.

(B) If the terms of any Option or Convertible Security, the issuance of which resulted in an adjustment to the Series A Conversion Price pursuant to the terms of Subsection 4(d)(iv) below, are revised as a result of an amendment to such terms or any other adjustment pursuant to the provisions of such Option or Convertible Security (but excluding automatic adjustments to such terms pursuant to anti-dilution or similar provisions of such Option or Convertible Security)[69] to provide for either (1) any increase or decrease in the number of shares of Common Stock issuable upon the exercise, conversion and/or exchange of any such Option or Convertible Security or (2) any increase or decrease in the consideration payable to the Corporation upon such exercise, conversion and/or exchange, then, effective upon such increase or decrease becoming effective, the Series A Conversion Price computed upon the original issue of such Option or Convertible Security (or upon the occurrence of a record date with respect thereto) shall be readjusted to such Series A Conversion Price as would have obtained had such revised terms been in effect upon the original date of issuance of such Option or Convertible Security. Notwithstanding the foregoing, no readjustment pursuant to this clause (B) shall have the effect of increasing the Series A Conversion Price to an amount which exceeds the lower of (i) the Series A Conversion Price in effect immediately prior to the original adjustment made as a result of the issuance of such Option or Convertible Security, or (ii) the Series A Conversion Price that would have resulted from any issuances of Additional Shares of Common Stock (other than deemed issuances of Additional Shares of Common Stock as a result of the issuance of such Option or Convertible Security) between the original adjustment date and such readjustment date.

(C) If the terms of any Option or Convertible Security (excluding Options or Convertible Securities which are themselves Exempted Securities), the

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[69] The reason for this parenthetical is that an automatic change in another security pursuant to its anti-dilution provisions would cause an automatic adjustment pursuant to this provision. If the adjustment pursuant to this provision then causes another automatic change in the other security, it is possible that the second change in the other security can cause a second change pursuant to this provision, which causes a third change to the other security and then a third adjustment pursuant to this provision, and on and on. This form does not provide for adjustment to the Series A Conversion Price as a result of anti-dilution adjustments to the terms of Options or Convertible Securities, because of the complexity involved in such calculations, and because the dilutive event triggering the adjustment to the terms of the Option or Convertible Security would presumably also trigger an adjustment to the Series A Conversion Price under the terms Subsection 4(d)(iv) (thus obviating the need to provide for an adjustment to the Series A Conversion Price as a result of an anti-dilution adjustment to the terms of the Option or Convertible Security).

issuance of which did not result in an adjustment to the Series A Conversion Price pursuant to the terms of Subsection 4(d)(iv) below (either because the consideration per share (determined pursuant to Subsection 4(d)(v) hereof) of the Additional Shares of Common Stock subject thereto was equal to or greater than the Series A Conversion Price then in effect, or because such Option or Convertible Security was issued before the Series A Original Issue Date), are revised after the Series A Original Issue Date as a result of an amendment to such terms or any other adjustment pursuant to the provisions of such Option or Convertible Security (but excluding automatic adjustments to such terms pursuant to anti-dilution or similar provisions of such Option or Convertible Security)[70] to provide for either (1) any increase or decrease in the number of shares of Common Stock issuable upon the exercise, conversion or exchange of any such Option or Convertible Security or (2) any increase or decrease in the consideration payable to the Corporation upon such exercise, conversion or exchange, then such Option or Convertible Security, as so amended or adjusted, and the Additional Shares of Common Stock subject thereto (determined in the manner provided in Subsection 4(d)(iii) above) shall be deemed to have been issued effective upon such increase or decrease becoming effective.

(D) Upon the expiration or termination of any unexercised Option or unconverted or unexchanged Convertible Security (or portion thereof) which resulted (either upon its original issuance or upon a revision of its terms) in an adjustment to the Series A Conversion Price pursuant to the terms of Subsection 4(d)(iv) below, the Series A Conversion Price shall be readjusted to such Series A Conversion Price as would have obtained had such Option or Convertible Security (or portion thereof) never been issued.

(E) If the number of shares of Common Stock issuable upon the exercise, conversion and/or exchange of any Option or Convertible Security, or the consideration payable to the Corporation upon such exercise, conversion and/or exchange, is calculable at the time such Option or Convertible Security is issued or amended but is subject to adjustment based upon subsequent events, any adjustment to the Series A Conversion Price provided for in this Subsection 4(d)(iii) shall be effected at the time of such issuance or amendment based on such number of shares or amount of consideration without regard to any provisions for subsequent adjustments (and any subsequent adjustments shall be treated as provided in clauses (B) and (C) of this Subsection 4(d)(iii). If the number of shares of Common Stock issuable upon the exercise, conversion and/or exchange of any Option or Convertible Security, or the consideration payable to the Corporation upon such exercise, conversion and/or

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[70] The reason for this parenthetical is that an automatic change in a another security pursuant to its anti-dilution provisions would cause an automatic adjustment pursuant to this provision. If the adjustment pursuant to this provision then causes another automatic change in the other security, it is possible that the second change in the other security can cause a second change pursuant to this provision, which causes a third change to the other security and then a third adjustment pursuant to this provision, and on and on. This form does not provide for adjustment to the Series A Conversion Price as a result of anti-dilution adjustments to the terms of Options or Convertible Securities, because of the complexity involved in such calculations, and because the dilutive event triggering the adjustment to the terms of the Option or Convertible Security would presumably also trigger an adjustment to the Series A Conversion Price under the terms Subsection 4(d)(iv) (thus obviating the need to provide for an adjustment to the Series A Conversion Price as a result of an anti-dilution adjustment to the terms of the Option or Convertible Security).

exchange, cannot be calculated at all at the time such Option or Convertible Security is issued or amended, any adjustment to the Series A Conversion Price that would result under the terms of this Subsection 4(d)(iii) at the time of such issuance or amendment shall instead be effected at the time such number of shares and/or amount of consideration is first calculable (assuming for purposes of calculating such adjustment to the Series A Conversion Price that such issuance or amendment took place at the time such calculation can first be made).

[Use the following clause (iv) if the terms sheet calls for a broad based weighted average anti-dilution provision]

(iv) Adjustment of Series A Conversion Price Upon Issuance of Additional Shares of Common Stock.[71] In the event the Corporation shall at any time after the Series A Original Issue Date issue Additional Shares of Common Stock (including Additional Shares of Common Stock deemed to be issued pursuant to Subsection 4(d)(iii)), without consideration or for a consideration per share less than the Series A Conversion Price in effect immediately prior to such issue, then the Series A Conversion Price shall be reduced, concurrently with such issue, to a price (calculated to the nearest [one-hundredth of a cent]) determined in accordance with the following formula:

$$CP_2 = CP_1 * (A + B) \div (A + C)$$

For purposes of the foregoing formula, the following definitions shall apply:

(A) CP_2 shall mean the Series A Conversion Price in effect immediately after such issue of Additional Shares of Common Stock

(B) CP_1 shall mean the Series A Conversion Price in effect immediately prior to such issue of Additional Shares of Common Stock;

(C) "A" shall mean the number of shares of Common Stock outstanding immediately prior to such issue of Additional Shares of Common Stock (treating for this purpose as outstanding all shares of Common Stock issuable upon exercise of Options outstanding immediately prior to such issue or upon conversion or exchange of Convertible Securities (including the Series A Preferred Stock) outstanding (assuming exercise of any outstanding Options therefore) immediately prior to such issue);

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[71] This subsection represents a typical "broad-based weighted average" anti-dilution provision. Broad-based anti-dilution is more founder-friendly than a "narrow-based" anti-dilution formula. Whether an anti-dilution provision is broad or narrow is determined by how broad or narrow the formula (set forth in clause (c) of this subsection) is for calculating the number of outstanding shares of Common Stock. An even broader formula would include in that calculation all shares reserved under stock plans, whether or not subject to outstanding options (on the theory that those shares are generally included when translating the "pre-money valuation" agreed between the Corporation and the Investors to a per share purchase price for the financing). In contrast, a narrower formula might include in the calculation of outstanding shares only those shares of Common Stock which are actually outstanding (i.e., excluding shares of Common Stock issuable on conversion of options, warrants and, potentially, even the Preferred Stock itself). While narrow-based anti-dilution formulas are more investor-friendly, the most investor-friendly category of anti-dilution protection is a "full ratchet" anti-dilution.

(D) "B" shall mean the number of shares of Common Stock that would have been issued if such Additional Shares of Common Stock had been issued at a price per share equal to CP_1 (determined by dividing the aggregate consideration received by the Corporation in respect of such issue by CP_1); and

(E) "C" shall mean the number of such Additional Shares of Common Stock issued in such transaction.

[Use the following clause (iv) if the term sheet calls for a full ratchet anti-dilution provision]

(iv) Adjustment of Series A Conversion Price Upon Issuance of Additional Shares of Common Stock. In the event the Corporation shall at any time after the Series A Original Issue Date issue Additional Shares of Common Stock (including Additional Shares of Common Stock deemed to be issued pursuant to Subsection 4(d)(iii)), without consideration or for a consideration per share less than the applicable Series A Conversion Price in effect immediately prior to such issue, then the Series A Conversion Price shall be reduced, concurrently with such issue, to the consideration per share received by the Corporation for such issue or deemed issue of the Additional Shares of Common Stock; provided that if such issuance or deemed issuance was without consideration, then the Corporation shall be deemed to have received an aggregate of [$.001] of consideration for all such Additional Shares of Common Stock issued or deemed to be issued.**]**

(v) Determination of Consideration. For purposes of this Subsection 4(d), the consideration received by the Corporation for the issue of any Additional Shares of Common Stock shall be computed as follows:

(A) Cash and Property: Such consideration shall:

(I) insofar as it consists of cash, be computed at the aggregate amount of cash received by the Corporation, excluding amounts paid or payable for accrued interest;

(II) insofar as it consists of property other than cash, be computed at the fair market value thereof at the time of such issue, as determined in good faith by the Board of Directors of the Corporation; and

(III) in the event Additional Shares of Common Stock are issued together with other shares or securities or other assets of the Corporation for consideration which covers both, be the proportion of such consideration so received, computed as provided in clauses (I) and (II) above, as determined in good faith by the Board of Directors of the Corporation.

(B) Options and Convertible Securities. The consideration per share received by the Corporation for Additional Shares of Common Stock deemed to have been issued pursuant to Subsection 4(d)(iii), relating to Options and Convertible Securities, shall be determined by dividing

(I) the total amount, if any, received or receivable by the Corporation as consideration for the issue of such Options or Convertible Securities, plus the minimum aggregate amount of additional consideration (as set forth in the instruments relating thereto, without regard to any provision contained therein for a subsequent adjustment of such consideration) payable to the Corporation upon the exercise of such Options or the conversion or exchange of such Convertible Securities, or in the case of Options for Convertible Securities, the exercise of such Options for Convertible Securities and the conversion or exchange of such Convertible Securities, by

(II) the maximum number of shares of Common Stock (as set forth in the instruments relating thereto, without regard to any provision contained therein for a subsequent adjustment of such number) issuable upon the exercise of such Options or the conversion of exchange of such Convertible Securities, or in the case of Options for Convertible Securities, the exercise of such Options for Convertible Securities and the conversion or exchange of such Convertible Securities.

(vi) Multiple Closing Dates. In the event the Corporation shall issue on more than one date Additional Shares of Common Stock that are a part of one transaction or a series of related transactions and that would result in an adjustment to the Series A Conversion Price pursuant to the terms of Subsection 4(d)(iv) above [, and such issuance dates occur within a period of no more than [90] days from the first such issuance to the final such issuance,] then, upon the final such issuance, the Series A Conversion Price shall be readjusted to give effect to all such issuances as if they occurred on the date of the first such issuance (and without giving

effect to any additional adjustments as a result of any such subsequent issuances within such period).

(e) Adjustment for Stock Splits and Combinations.[72] If the Corporation shall at any time or from time to time after the Series A Original Issue Date effect a subdivision of the outstanding Common Stock, the Series A Conversion Price in effect immediately before that subdivision shall be proportionately decreased so that the number of shares of Common Stock issuable on conversion of each share of such series shall be increased in proportion to such increase in the aggregate number of shares of Common Stock outstanding. If the Corporation shall at any time or from time to time after the Series A Original Issue Date combine the outstanding shares of Common Stock, the Series A Conversion Price in effect immediately before the combination shall be proportionately increased so that the number of shares of Common Stock issuable on conversion of each share of such series shall be decreased in proportion to such decrease in the aggregate number of shares of Common Stock outstanding. Any adjustment under this subsection shall become effective at the close of business on the date the subdivision or combination becomes effective.

(f) Adjustment for Certain Dividends and Distributions. In the event the Corporation at any time or from time to time after the Series A Original Issue Date shall make or issue, or fix a record date for the determination of holders of Common Stock entitled to receive, a dividend or other distribution payable on the Common Stock in additional shares of Common Stock, then and in each such event the Series A Conversion Price in effect immediately before such event shall be decreased as of the time of such issuance or, in the event such a record date shall have been fixed, as of the close of business on such record date, by multiplying the Series A Conversion Price then in effect by a fraction:

(1) the numerator of which shall be the total number of shares of Common Stock issued and outstanding immediately prior to the time of such issuance or the close of business on such record date, and

(2) the denominator of which shall be the total number of shares of Common Stock issued and outstanding immediately prior to the time of such issuance or the close of business on such record date plus the number of shares of Common Stock issuable in payment of such dividend or distribution;

Notwithstanding the foregoing, (i) if such record date shall have been fixed and such dividend is not fully paid or if such distribution is not fully made on the date fixed therefor, the Series A Conversion Price shall be recomputed accordingly as of the close of business on such record date and thereafter the Series A Conversion Price shall be adjusted pursuant to this subsection as of the time of actual payment of such dividends or distributions; and (ii) that no such adjustment shall be made if the holders of Series A Preferred Stock simultaneously receive a dividend or other distribution of shares of Common Stock in a number equal to the number of shares of

[72] This subsection and the subsections that follow do not provide for any adjustment to the Series A Conversion Price in the event of stock splits, etc. affecting the Series A Preferred Stock, because those adjustments are covered by the definition of Series A Original Issue Price, which automatically adjusts the numerator of the conversion ratio.

Common Stock as they would have received if all outstanding shares of Series A Preferred Stock had been converted into Common Stock on the date of such event.

(g) Adjustments for Other Dividends and Distributions. In the event the Corporation at any time or from time to time after the Series A Original Issue Date shall make or issue, or fix a record date for the determination of holders of Common Stock entitled to receive, a dividend or other distribution payable in securities of the Corporation (other than a distribution of shares of Common Stock in respect of outstanding shares of Common Stock) or in other property and the provisions of Section (C)(1) do not apply to such dividend or distribution, then and in each such event the holders of Series A Preferred Stock shall receive, simultaneously with the distribution to the holders of Common Stock, a dividend or other distribution of such securities or other property in an amount equal to the amount of such securities or other property as they would have received if all outstanding shares of Series A Preferred Stock had been converted into Common Stock on the date of such event.[73]

(h) Adjustment for Merger or Reorganization, etc. Subject to the provisions of Subsection 2(c), if there shall occur any reorganization, recapitalization, reclassification, consolidation or merger involving the Corporation in which the Common Stock (but not the Series A Preferred Stock) is converted into or exchanged for securities, cash or other property (other than a transaction covered by Subsections (e), (f) or (g) of this Section 4), then, following any such reorganization, recapitalization, reclassification, consolidation or merger, each share of Series A Preferred Stock shall thereafter be convertible in lieu of the Common Stock into which it was convertible prior to such event into the kind and amount of securities, cash or other property which a holder of the number of shares of Common Stock of the Corporation issuable upon conversion of one share of Series A Preferred Stock immediately prior to such reorganization, recapitalization, reclassification, consolidation or merger would have been entitled to receive pursuant to such transaction; and, in such case, appropriate adjustment (as determined in good faith by the Board of Directors of the Corporation) shall be made in the application of the provisions in this Section 4 with respect to the rights and interests thereafter of the holders of the Series A Preferred Stock, to the end that the provisions set forth in this Section 4 (including provisions with respect to changes in and other adjustments of the Series A Conversion Price) shall thereafter be applicable, as nearly as reasonably may be, in relation to any securities or other property thereafter deliverable upon the conversion of the Series A Preferred Stock.

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[73] Alternative provision: add the following after "in each such event" in place of the current text – provision shall be made so that the holders of the Series A Preferred Stock shall receive upon conversion thereof, in addition to the number of shares of Common Stock receivable thereupon, the kind and amount of securities of the Corporation, cash or other property which they would have been entitled to receive had the Series A Preferred Stock been converted into Common Stock on the date of such event and had they thereafter, during the period from the date of such event to and including the conversion date, retained such securities receivable by them as aforesaid during such period, giving application to all adjustments called for during such period under this paragraph with respect to the rights of the holders of the Series A Preferred Stock; provided, however, that no such provision shall be made if the holders of Series A Preferred Stock receive, simultaneously with the distribution to the holders of Common Stock, a dividend or other distribution of such securities, cash or other property in an amount equal to the amount of such securities, cash or other property as they would have received if all outstanding shares of Series A Preferred Stock had been converted into Common Stock on the date of such event.

(i) Certificate as to Adjustments. Upon the occurrence of each adjustment or readjustment of the Series A Conversion Price pursuant to this Section 4, the Corporation at its expense shall, as promptly as reasonably practicable but in any event not later than [10] days thereafter, compute such adjustment or readjustment in accordance with the terms hereof and furnish to each holder of Series A Preferred Stock a certificate setting forth such adjustment or readjustment (including the kind and amount of securities, cash or other property into which the Series A Preferred Stock is convertible) and showing in detail the facts upon which such adjustment or readjustment is based. The Corporation shall, as promptly as reasonably practicable after the written request at any time of any holder of Series A Preferred Stock (but in any event not later than [10] days thereafter), furnish or cause to be furnished to such holder a certificate setting forth (i) the Series A Conversion Price then in effect, and (ii) the number of shares of Common Stock and the amount, if any, of other securities, cash or property which then would be received upon the conversion of Series A Preferred Stock.

(j) Notice of Record Date. In the event:

(i) the Corporation shall take a record of the holders of its Common Stock (or other capital stock or securities at the time issuable upon conversion of the Series A Preferred Stock) for the purpose of entitling or enabling them to receive any dividend or other distribution, or to receive any right to subscribe for or purchase any shares of capital stock of any class or any other securities, or to receive any other security; or

(ii) of any capital reorganization of the Corporation, any reclassification of the Common Stock of the Corporation, or any Deemed Liquidation Event; or

(iii) of the voluntary or involuntary dissolution, liquidation or winding-up of the Corporation,

then, and in each such case, the Corporation will send or cause to be sent to the holders of the Series A Preferred Stock a notice specifying, as the case may be, (i) the record date for such dividend, distribution or right, and the amount and character of such dividend, distribution or right, or (ii) the effective date on which such reorganization, reclassification, consolidation, merger, transfer, dissolution, liquidation or winding-up is proposed to take place, and the time, if any is to be fixed, as of which the holders of record of Common Stock (or such other capital stock or securities at the time issuable upon the conversion of the Series A Preferred Stock) shall be entitled to exchange their shares of Common Stock (or such other capital stock or securities) for securities or other property deliverable upon such reorganization, reclassification, consolidation, merger, transfer, dissolution, liquidation or winding-up, and the amount per share and character of such exchange applicable to the Series A Preferred Stock and the Common Stock. Such notice shall be sent at least [10] days prior to the record date or effective date for the event specified in such notice.

5. Mandatory Conversion.

(a) Trigger Events. Upon either (A) the closing of the sale of shares of Common Stock to the public at a price of at least $[_____] per share (subject to appropriate adjustment in the event of any stock dividend, stock split, combination or other similar

recapitalization affecting such shares), in a [firm-commitment] underwritten public offering pursuant to an effective registration statement under the Securities Act of 1933, as amended, resulting in at least $[_____] of [gross] proceeds [, net of the underwriting discount and commissions,] to the Corporation or (B) the date and time, or the occurrence of an event, specified by vote or written consent of the holders of at least *[specify percentage]* [74] of the then outstanding shares of Series A Preferred Stock (the time of such closing or the date and time specified or the time of the event specified in such vote or written consent is referred to herein as the "**Mandatory Conversion Time**"), (i) all outstanding shares of Series A Preferred Stock shall automatically be converted into shares of Common Stock, at the then effective conversion rate and (ii) such shares may not be reissued by the Corporation.

(b) Procedural Requirements. All holders of record of shares of Series A Preferred Stock shall be sent written notice of the Mandatory Conversion Time and the place designated for mandatory conversion of all such shares of Series A Preferred Stock pursuant to this Section 5. Such notice need not be sent in advance of the occurrence of the Mandatory Conversion Time. Upon receipt of such notice, each holder of shares of Series A Preferred Stock shall surrender his, her or its certificate or certificates for all such shares (or, if such holder alleges that such certificate has been lost, stolen or destroyed, a lost certificate affidavit and agreement reasonably acceptable to the Corporation to indemnify the Corporation against any claim that may be made against the Corporation on account of the alleged loss, theft or destruction of such certificate) to the Corporation at the place designated in such notice, and shall thereafter receive certificates for the number of shares of Common Stock to which such holder is entitled pursuant to this Section 5. At the Mandatory Conversion Time, all outstanding shares of Series A Preferred Stock shall be deemed to have been converted into shares of Common Stock, which shall be deemed to be outstanding of record, and all rights with respect to the Series A Preferred Stock so converted, including the rights, if any, to receive notices and vote (other than as a holder of Common Stock), will terminate, except only the rights of the holders thereof, upon surrender of their certificate or certificates (or lost certificate affidavit and agreement) therefor, to receive the items provided for in the last sentence of this Subsection 5(b). If so required by the Corporation, certificates surrendered for conversion shall be endorsed or accompanied by written instrument or instruments of transfer, in form satisfactory to the Corporation, duly executed by the registered holder or by his, her or its attorney duly authorized in writing. As soon as practicable after the Mandatory Conversion Time and the surrender of the certificate or certificates (or lost certificate affidavit and agreement) for Series A Preferred Stock, the Corporation shall issue and deliver to such holder, or to his, her or its nominees, a certificate or certificates for the number of full shares of Common Stock issuable on such conversion in accordance with the provisions hereof, together with cash as provided in Subsection 4(b) in lieu of any fraction of a share of Common Stock otherwise issuable upon such conversion and the payment of any declared but unpaid dividends [(but not any undeclared Accruing Dividends)][75] on the shares of Series A Preferred Stock converted.

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[74] Corporations Code §403(a)(1) requires a vote of at least a majority of the outstanding shares of the class or series to be converted.

[75] Include if there are accruing dividends on the Series A Preferred Stock.

(c) Effect of Mandatory Conversion. All certificates evidencing shares of Series A Preferred Stock which are required to be surrendered for conversion in accordance with the provisions hereof shall, from and after the Mandatory Conversion Time, be deemed to have been retired and cancelled and the shares of Series A Preferred Stock represented thereby converted into Common Stock for all purposes, notwithstanding the failure of the holder or holders thereof to surrender such certificates on or prior to such date. Such converted Series A Preferred Stock may not be reissued as shares of such series, and the Corporation may thereafter take such appropriate action (without the need for shareholder action) as may be necessary to reduce the authorized number of shares of Series A Preferred Stock accordingly.

[Use the following Section 5A if the Term Sheet calls for a pay-to-play provision where the consequence is conversion into Common Stock][76]

5.A Special Mandatory Conversion.

(a) Trigger Event. In the event that any holder of shares of Series A Preferred Stock does not participate in a Qualified Financing (as defined below) by purchasing in the aggregate, in such Qualified Financing and within the time period specified by the Corporation (provided that the Corporation has sent to each holder of Series A Preferred Stock at least 10 days written notice of, and the opportunity to purchase its Pro Rata Amount (as defined below) of, the Qualified Financing), such holder's Pro Rata Amount, [then each share] [then the Applicable Portion (as defined below) of the shares] of Series A Preferred Stock held by such holder shall automatically, and without any further action on the part of such holder, be converted into shares of Common Stock at the Series A Conversion Price in effect immediately prior to the consummation of such Qualified Financing, effective upon, subject to, and concurrently with, the consummation of the Qualified Financing. For purposes of determining the number of shares of Series A Preferred Stock owned by a holder, and for determining the number of Offered Securities (as defined below) a holder of Series A Preferred Stock has purchased in a Qualified Financing, all shares of Series A Preferred Stock held by Affiliates (as defined below) of such holder shall be aggregated with such holder's shares and all Offered Securities purchased by Affiliates of such holder shall be aggregated with the Offered Securities purchased by such holder (provided that no shares or securities shall be attributed to more than one entity or person within any such group of affiliated entities or persons). Such conversion is referred to as a "**Special Mandatory Conversion**".[77]

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[76] Structuring the pay-to-play provision so that the Series A Preferred Stock of a non-participating investor converts into Common Stock (rather than a "shadow series" of Preferred Stock) is generally preferable, because: (1) this is a stronger consequence; (2) under the Corporations Code, certain charter amendments may not be effected without the approval of the holders of a majority of the outstanding shares of the new shadow series of Preferred Stock; and (3) conversion to Common Stock avoids the complexities associated with the creation of the shadow series of Preferred Stock.

[77] Careful consideration must be given to whether shares of Series A Preferred Stock converted upon a Special Mandatory Conversion should lose the contractual rights provided under the various ancillary agreements typically involved in a Preferred Stock financing (e.g., registration rights, pre-emptive rights, etc.).

(b) Procedural Requirements. Upon a Special Mandatory Conversion, each holder of shares of Series A Preferred Stock converted pursuant to Subsection 5A(a) shall surrender his, her or its certificate or certificates for all such shares (or, if such holder alleges that such certificate has been lost, stolen or destroyed, a lost certificate affidavit and agreement reasonably acceptable to the Corporation to indemnify the Corporation against any claim that may be made against the Corporation on account of the alleged loss, theft or destruction of such certificate) to the Corporation at the place designated in such notice, and shall thereafter receive certificates for the number of shares of Common Stock to which such holder is entitled pursuant to this Section 5A [and a new certificate for the number of shares, if any, of Series A Preferred Stock represented by such surrendered certificate and not converted pursuant to Subsection 5A(a)].[78] All rights with respect to the Series A Preferred Stock converted pursuant to Subsection 5A(a), including the rights, if any, to receive notices and vote (other than as a holder of Common Stock), will terminate, except only the rights of the holders thereof, upon surrender of their certificate or certificates therefor (or lost certificate affidavit and agreement), to receive the items provided for in the last sentence of this Subsection 5A(b). If so required by the Corporation, certificates surrendered for conversion shall be endorsed or accompanied by written instrument or instruments of transfer, in form satisfactory to the Corporation, duly executed by the registered holder or by his, her or its attorney duly authorized in writing. As soon as practicable after the Special Mandatory Conversion and the surrender of the certificate or certificates (or lost certificate affidavit and agreement) for Series A Preferred Stock so converted, the Corporation shall issue and deliver to such holder, or to his, her or its nominees, a certificate or certificates for the number of full shares of Common Stock issuable on such conversion in accordance with the provisions hereof, together with cash as provided in Subsection 4(b) in lieu of any fraction of a share of Common Stock otherwise issuable upon such conversion and the payment of any declared but unpaid dividends [(but not any undeclared Accruing Dividends)][79] on the shares of Series A Preferred Stock converted [and a new certificate for the number of shares, if any, of Series A Preferred Stock represented by such surrendered certificate and not converted pursuant to Subsection 5A.1].[80]

(c) Effect of Special Mandatory Conversion. All certificates evidencing shares of Series A Preferred Stock which are required to be surrendered for conversion in accordance with the provisions hereof shall, from and after the time of the Special Mandatory Conversion, be deemed to have been retired and cancelled, and the shares of Series A Preferred Stock converted pursuant to Section 5A(a) represented thereby shall, from and after the time of the Special Mandatory Conversion, be deemed to have been converted into Common Stock for all purposes, notwithstanding the failure of the holder or holders thereof to surrender such certificates on or prior to such date. Such converted Series A Preferred Stock may not be reissued as shares of such series, and the Corporation may thereafter take such appropriate action

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[78] Applicable only if proportional conversion is provided for by the Articles of Incorporation.

[79] Include if there are accruing dividends on the Series A Preferred Stock.

[80] Applicable only if proportional conversion is provided for by the Articles of Incorporation.

(without the need for shareholder action) as may be necessary to reduce the authorized number of shares of Series A Preferred Stock accordingly.

(d) Definitions. For purposes of this Section 5A, the following definitions shall apply:

(i) "**Affiliate**" shall mean, with respect to any holder of shares of Series A Preferred Stock, any person, entity or firm which, directly or indirectly, controls, is controlled by or is under common control with such holder, including, without limitation, any entity of which the holder is a partner or member, any partner, officer, director, member or employee of such holder and any venture capital fund now or hereafter existing of which the holder is a partner or member which is controlled by or under common control with one or more general partners of such holder or shares the same management company with such holder.

(ii) ["**Applicable Portion**" shall mean, with respect to any holder of shares of Series A Preferred Stock, a number of shares of Series A Preferred Stock calculated by multiplying the aggregate number of shares of Series A Preferred Stock held by such holder immediately prior to a Qualified Financing by a fraction, the numerator of which is equal to the amount, if positive, by which such holder's Pro Rata Amount exceeds the number of Offered Securities actually purchased by such holder in such Qualified Financing, and the denominator of which is equal to such holder's Pro Rata Amount.][81]

(iii) "**Offered Securities**" shall mean the equity securities of the Corporation set aside by the Board of Directors of the Corporation for purchase by holders of outstanding shares of Series A Preferred Stock in connection with a Qualified Financing, and offered to such holders .

(iv) "**Pro Rata Amount**" shall mean, with respect to any holder of Series A Preferred Stock, the lesser of (a) a number of Offered Securities calculated by multiplying the aggregate number of Offered Securities by a fraction, the numerator of which is equal to [the number of shares of Series A Preferred Stock owned by such holder, and the denominator of which is equal to the aggregate number of outstanding shares of Series A Preferred Stock],[82] or (b) the maximum number of Offered Securities that such holder is permitted by the Corporation to purchase in such Qualified Financing, after giving effect to any cutbacks or limitations established by the Board of Directors and applied on a pro rata basis to all holders of Series A Preferred Stock.

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[81] Applicable only if proportional conversion is provided for by the Articles of Incorporation.

[82] Alternative: "the number of shares of outstanding Common Stock owned by such holder, and the denominator of which is equal to the aggregate number of shares of outstanding Common Stock (for the purpose of this definition, treating all shares of Common Stock issuable upon exercise of Options outstanding immediately prior to such Qualified Financing or upon conversion of Convertible Securities outstanding (assuming exercise of any outstanding Options therefor) immediately prior to such Qualified Financing as outstanding)."

(v) "**Qualified Financing**" shall mean any transaction involving the issuance or sale of equity securities of the Corporation after the Series A Original Issue Date which would result in [at least $_____ in gross proceeds to the Corporation and] the reduction of the Series A Conversion Price pursuant to the terms of the Articles of Incorporation (without giving effect to the operation of Subsection 4(d)(iii)(b)), unless the holders of at least [*specify percentage*][83] of the Series A Preferred Stock elect, by written notice sent to the Corporation at least [__] days prior to the consumment of the Qualified Financing, that such transaction not be treated as a Qualified Financing for purposes of this Section 5A.

[Use the following Section 5A if the Term Sheet calls for a pay-to-play provision where the consequence is conversion into a new series of Preferred Stock. Note that this provision requires blank check Preferred authority as set forth in Section B. 2 above.]

5.A Special Mandatory Conversion.

(a) Trigger Event. In the event that any holder of shares of Series A Preferred Stock does not participate in a Qualified Financing (as defined below) by purchasing in the aggregate, in such Qualified Financing and within the time period specified by the Corporation (provided that the Corporation has sent to each holder of Series A Preferred Stock at least 10 days written notice of, and the opportunity to purchase its Pro Rata Amount (as defined below) of, the Qualified Financing), such holder's Pro Rata Amount, then effective upon, subject to, and concurrently with, the consummation of the Qualified Financing, [all shares] [the Applicable Portion (as defined below) of the shares] of Series A Preferred Stock held by such holder shall automatically, and without any further action on the part of such holder, be converted on a share-for-share basis into shares of a newly created series of Preferred Stock (having such number of shares as equals the number of shares converted pursuant to this Section 5A on account of the holders' failure to participate in the Qualified Financing), which newly created series shall be identical in all respects to the Series A Preferred Stock except that (i) the conversion price of such series shall be fixed at the Series A Conversion Price in effect immediately prior to the consummation of the Qualified Financing and shall not be subject to any further adjustment analogous to that set forth in Subsection 4(d)(iv) above and (ii) such new series shall not include a provision analogous to this Section 5A (each such new series of Preferred Stock, the "**New Preferred Stock**"). The Board of Directors shall take all necessary actions to designate each such series of New Preferred Stock prior to the consummation of each Qualified Financing that would trigger a Special Mandatory Conversion (as defined below), and the taking of such action shall be a condition to the Special Mandatory Conversion. For purposes of determining the number of shares of Series A Preferred Stock owned by a holder, and for determining the number of Offered Securities (as defined below) a holder of Series A Preferred Stock has purchased in a Qualified Financing, all shares of Series A Preferred Stock held by Affiliates (as defined below) of such holder shall be aggregated with such holder's shares and all Offered Securities purchased by Affiliates of such holder shall be aggregated with the Offered Securities purchased by such holder (provided that no shares or securities shall be attributed to more than

[83] As discussed in the introductory commentary to this form, Corporations Code § 710 bars super-majority voting requirements in excess of 66 2/3 % for most public and many private California corporations.

one entity or person within any such group of affiliated entities or persons). Such conversion is referred to as a "**Special Mandatory Conversion**".[84]

(b) Procedural Requirements. Upon a Special Mandatory Conversion, each holder of shares of Series A Preferred Stock converted pursuant to Section 5A(a) shall surrender his, her or its certificate or certificates for all such shares (or, if such holder alleges that such certificate has been lost, stolen or destroyed, a lost certificate affidavit and agreement reasonably acceptable to the Corporation to indemnify the Corporation against any claim that may be made against the Corporation on account of the alleged loss, theft or destruction of such certificate) to the Corporation at the place designated in such notice, and shall thereafter receive certificates for the number of shares of New Preferred Stock to which such holder is entitled pursuant to this Section 5A [and a new certificate for the number of shares, if any, of Series A Preferred Stock represented by such surrendered certificate and not converted pursuant to Section 5A(a)].[85] All rights with respect to the Series A Preferred Stock converted pursuant to Section 5A(a), including the rights, if any, to receive notices and vote (other than as a holder of New Preferred Stock), will terminate, except only the rights of the holders thereof, upon surrender of their certificate or certificates (or lost certificate affidavit and agreement) therefor, to receive the items provided for in the last sentence of this section 5A(b). If so required by the Corporation, certificates surrendered for conversion shall be endorsed or accompanied by written instrument or instruments of transfer, in form satisfactory to the Corporation, duly executed by the registered holder or by his, her or its attorney duly authorized in writing. As soon as practicable after the Special Mandatory Conversion and the surrender of the certificate or certificates (or lost certificate affidavit and agreement) for Series A Preferred Stock so converted, the Corporation shall issue and deliver to such holder, or to his, her or its nominees, a certificate or certificates for the number of full shares of New Preferred Stock issuable on such conversion in accordance with the provisions hereof, together with cash as provided in Subsection 4(b) in lieu of any fraction of a share of New Preferred Stock otherwise issuable upon such conversion and the payment of any declared but unpaid dividends [(but not any undeclared Accruing Dividends)][86] on the shares of Series A Preferred Stock converted [and a new certificate for the number of shares, if any, of Series A Preferred Stock represented by such surrendered certificate and not converted pursuant to Section 5A(a)].[87]

(c) Effect of Special Mandatory Conversion. All certificates evidencing shares of Series A Preferred Stock which are required to be surrendered for conversion in accordance with the provisions hereof shall, from and after the time of the Special Mandatory Conversion, be deemed to have been retired and cancelled, and the shares of Series A Preferred

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[84] Careful consideration must be given to whether shares of Series A Preferred Stock converted upon a Special Mandatory Conversion should lose the contractual rights provided under the various ancillary agreements typically involved in a Preferred Stock financing (e.g., registration rights, pre-emptive rights, etc.).

[85] Applicable only if proportional conversion is provided for by the Articles of Incorporation.

[86] Include if there are accruing dividends on the Series A Preferred Stock.

[87] Applicable only if proportional conversion is provided for by the Articles of Incorporation.

Stock converted pursuant to Section 5A(a) represented thereby shall, from and after the time of the Special Mandatory Conversion, be deemed to have been converted into New Preferred Stock for all purposes, notwithstanding the failure of the holder or holders thereof to surrender such certificates on or prior to such date. Such converted Series A Preferred Stock may not be reissued as shares of such series, and the Corporation may thereafter take such appropriate action (without the need for shareholder action) as may be necessary to reduce the authorized number of shares of Series A Preferred Stock accordingly.

(d) Class Voting Rights Notwithstanding any other provisions in the Articles of Incorporation to the contrary, in the event that one or more series of New Preferred Stock are established, any reference in the terms of the Series A Preferred Stock or of such series of New Preferred Stock to the rights of the holders thereof to consent, vote or otherwise take action separately as a class (other than a waiver given with respect to the terms of Section 4(d)(iv) of the Series A Preferred Stock terms, to which this sentence shall not apply) shall be deemed to refer to a consent, vote or other action by the holders of the specified percentage of all outstanding shares of the Series A Preferred Stock and each series of New Preferred Stock, considered together as a single class.

(e) Definitions. For purposes of this Section 5A, the following definitions shall apply:

(i) "**Affiliate**" shall mean, with respect to any holder of shares of Series A Preferred Stock, any person, entity or firm which, directly or indirectly, controls, is controlled by or is under common control with such holder, including, without limitation, any entity of which the holder is a partner or member, any partner, officer, director, member or employee of such holder and any venture capital fund now or hereafter existing of which the holder is a partner or member which is controlled by or under common control with one or more general partners of such holder or shares the same management company with such holder.

(ii) ["**Applicable Portion**" shall mean, with respect to any holder of shares of Series A Preferred Stock, a number of shares of Series A Preferred Stock calculated by multiplying the aggregate number of shares of Series A Preferred Stock held by such holder immediately prior to a Qualified Financing by a fraction, the numerator of which is equal to the amount, if positive, by which such holder's Pro Rata Amount exceeds the number of Offered Securities actually purchased by such holder in such Qualified Financing, and the denominator of which is equal to such holder's Pro Rata Amount.][88]

(iii) "**Offered Securities**" shall mean the equity securities of the Corporation set aside by the Board of Directors for purchase by holders of outstanding shares of Series A Preferred Stock in connection with a Qualified Financing, and offered to such holders .

(iv) "**Pro Rata Amount**" shall mean, with respect to any holder of Series A Preferred Stock, the lesser of (a) a number of Offered Securities calculated by

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[88] Applicable only if proportional conversion is provided for by the Articles of Incorporation.

multiplying the aggregate number of Offered Securities by a fraction, the numerator of which is equal to [the number of shares of Series A Preferred Stock owned by such holder, and the denominator of which is equal to the aggregate number of outstanding shares of Series A Preferred Stock],[89] or (b) the maximum number of Offered Securities that such holder is permitted by the Corporation to purchase in such Qualified Financing, after giving effect to any cutbacks or limitations established by the Board of Directors and applied on a pro rata basis to all holders of Series A Preferred Stock.

(v) "**Qualified Financing**" shall mean any transaction involving the issuance or sale of equity securities of the Corporation after the Series A Original Issue Date which would result in [at least $___ in gross proceeds to the Corporation and] the reduction of the Series A Conversion Price pursuant to the terms of the Articles of Incorporation (without giving effect to the operation of Subsection 4(d)(iii)(b), unless the holders of at least [*specify percentage*][90] of the Series A Preferred Stock elect, by written notice sent to the Corporation at least [__] days prior to the consummation of the Qualified Financing, that such transaction not be treated as a Qualified Financing for purposes of this Section 5A.

6. Redemption.[91]

(a) Redemption. Shares of Series A Preferred Stock shall be redeemed by the Corporation out of funds lawfully available[92] therefor at a price equal to [the Series A Original Issue Price per share, plus all declared but unpaid dividends thereon][93] (the "**Redemption Price**"),[94] in three annual installments commencing 60 days after receipt by the Corporation at

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[89] Alternative: "the number of shares of outstanding Common Stock owned by such holder, and the denominator of which is equal to the aggregate number of shares of outstanding Common Stock for the purpose of this definition, treating all shares of Common Stock issuable upon exercise of Options outstanding immediately prior to such Qualified Financing or upon conversion of Convertible Securities outstanding (assuming exercise of any outstanding Options therefor) immediately prior to such Qualified Financing as outstanding)."

[90] As discussed in the introductory commentary to this form, Corporations Code § 710 bars super-majority voting requirements in excess of 66 2/3 % for most public and many private California corporations.

[91] Redemption provisions are more common in East Coast venture transactions than in West Coast venture transactions. In the event the Series A Preferred Stock will not be redeemable, replace Section 6 with: "6. Redemption. The Series A Preferred Stock is not redeemable except in accordance with the Deemed Liquidation provisions of Subsection 2(c)(iii)."

[92] As discussed in the introductory commentary, Corporations Code §§ 166 and 500 limit distributions of cash or property to shareholders.

[93] Replace with the following if cumulative dividends are selected: "the Series A Original Issue Price, plus any Accruing Dividends accrued but unpaid thereon, whether or not declared, together with any other dividends declared but unpaid thereon"

[94] Redemption prices are sometimes fixed at the greater of the Series A Original Issue Price (plus dividends) and the fair market value of the Series A Preferred Stock on the date of the Redemption Notice or the date of redemption. When structuring redeemable Preferred Stock, consideration should be given to Section 305(c) of the Internal Revenue Code. Section 305(c) provides that, in certain circumstances, redemption premiums on Preferred Stock are treated for tax purposes in the same manner as original issue discount on bonds. That is,

any time on or after [_____], from the holders of at least [*specify percentage*[95]] of the then outstanding shares of Series A Preferred Stock, of written notice requesting redemption of all shares of Series A Preferred Stock[96] (the date of each such installment being referred to as a "**Redemption Date**"). On each Redemption Date, the Corporation shall redeem, on a pro rata basis in accordance with the number of shares of Series A Preferred Stock owned by each holder, that number of outstanding shares of Series A Preferred Stock determined by dividing (i) the total number of shares of Series A Preferred Stock outstanding immediately prior to such Redemption Date by (ii) the number of remaining Redemption Dates (including the Redemption Date to which such calculation applies) [; provided, however, that Excluded Shares (as such term is defined in subsection (b) of this Section 6) shall not be redeemed and shall be excluded from the calculations set forth in this sentence.][97] If the Corporation does not have sufficient funds legally available to redeem on any Redemption Date all shares of Series A Preferred Stock [and of any other class or series of capital stock to be redeemed on such Redemption Date],[98] the

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redemption premiums are generally treated as being distributed to the holders of Preferred Stock over the period that the Preferred Stock is outstanding (the "Constructive Distribution Rule"). Distribution amounts for tax periods prior to redemption are determined by applying the yield to maturity (determined as the discount rate that, when used to compute the present value of the redemption price, produces an amount equal to the issue price of the Preferred Stock) to the issue price plus previously accrued amounts. If Preferred Stock is subject to either an automatic redemption or a redemption at the request of the Preferred Stock holders, the only exception to the Constructive Distribution Rule is for a redemption premium that is de minimis in amount (the "De Minimis Exception"). The De Minimis Exception applies where the amount by which the redemption price at maturity exceeds the issue price is less than one-quarter of one percent (.25%) of the redemption price multiplied by the number of complete years to maturity.

It is important to note that the Constructive Distribution Rule only applies to stock that is treated as "preferred stock" for tax purposes. Applicable Treasury Regulations under Code Section 305 indicate that a class of stock will be treated as "preferred stock" only if it has limited rights to participate in the growth of the issuer (as determined without regard to any conversion right inherent in the stock). Thus, Preferred Stock with unlimited rights to participate (a) in dividend distributions and (b) upon liquidation in excess of any stated preference (all as determined without regard to any right to convert such stock into Common Stock) will allow holders of such Preferred Stock to assert that their stock is not "preferred stock" for tax purposes. Note that even "nonparticipating" Preferred Stock can be structured in this manner by providing (as does this form) that upon liquidation of the Corporation the Preferred Stock will receive the greater of (i) its liquidation preference or (ii) the amount the holders of such Preferred Stock would receive if the proceeds were distributed to holders based on the number of shares of Common Stock into which the Preferred Stock could then be converted.

[95] Corporations Code §402(a) requires the vote of at least a majority of the outstanding shares of the class or series to be redeemed.

[96] The Corporation's accountants may take the position that, because the Series A Preferred Shareholders have the right to force a redemption, the Preferred Stock should be reflected above the shareholders' equity section of the Corporation's balance sheet, as opposed to in the shareholders' equity section of the balance sheet. If so, it is not uncommon for a Corporation to have negative shareholders' equity. The Corporation may want to consult with its accountants about this.

[97] The bracketed language, although not commonplace, may be desirable to minority investors in the Series A Preferred. If this is included, also include the applicable bracketed language in Section 6(b).

[98] Language not needed if no blank check preferred.

Corporation shall redeem a pro rata portion of each holder's redeemable shares of such capital stock out of funds legally available therefor, based on the respective amounts which would otherwise be payable in respect of the shares to be redeemed if the legally available funds were sufficient to redeem all such shares, and shall redeem the remaining shares to have been redeemed as soon as practicable after the Corporation has funds legally available therefor.[99]

(b) Redemption Notice. Written notice of the mandatory redemption (the "**Redemption Notice**") shall be sent to each holder of record of Series A Preferred Stock not less than 40 days prior to each Redemption Date. Each Redemption Notice shall state:

(I) the number of shares of Series A Preferred Stock held by the holder that the Corporation shall redeem on the Redemption Date specified in the Redemption Notice;

(II) the Redemption Date and the Redemption Price;

(III) the date upon which the holder's right to convert such shares terminates (as determined in accordance with Section 4(a)); and

(IV) that the holder is to surrender to the Corporation, in the manner and at the place designated, his, her or its certificate or certificates representing the shares of Series A Preferred Stock to be redeemed.

[If the Corporation receives, on or prior to the 20th day after the date of delivery of the Redemption Notice to a holder of Series A Preferred Stock, written notice from such holder that such holder elects to be excluded from the redemption provided in this Section 6, then the shares of Series A Preferred Stock registered on the books of the Corporation in the name of such holder at the time of the Corporation's receipt of such notice shall thereafter be "**Excluded Shares**".]

(c) Surrender of Certificates; Payment. On or before the applicable Redemption Date, each holder of shares of Series A Preferred Stock to be redeemed on such Redemption Date, unless such holder has exercised his, her or its right to convert such shares as provided in Section 4 hereof, shall surrender the certificate or certificates representing such shares (or, if such registered holder alleges that such certificate has been lost, stolen or destroyed, a lost certificate affidavit and agreement reasonably acceptable to the Corporation to indemnify the Corporation against any claim that may be made against the Corporation on account of the alleged loss, theft or destruction of such certificate) to the Corporation, in the manner and at the place designated in the Redemption Notice, and thereupon the Redemption Price for such shares shall be payable to the order of the person whose name appears on such certificate or certificates

[99] Investors may seek penalty provisions for a failure to redeem, including provisions which may entitle the Investors to gain control of the Board of Directors.

as the owner thereof. In the event less than all of the shares of Series A Preferred Stock represented by a certificate are redeemed, a new certificate representing the unredeemed shares of Series A Preferred Stock shall promptly be issued to such holder.

(d) Rights Subsequent to Redemption. If the Redemption Notice shall have been duly given, and if on the applicable Redemption Date the Redemption Price payable upon redemption of the shares of Series A Preferred Stock to be redeemed on such Redemption Date is paid or tendered for payment or deposited with an independent payment agent so as to be available therefor, then notwithstanding that the certificates evidencing any of the shares of Series A Preferred Stock so called for redemption shall not have been surrendered, dividends with respect to such shares of Series A Preferred Stock shall cease to accrue after such Redemption Date and all rights with respect to such shares shall forthwith after the Redemption Date terminate, except only the right of the holders to receive the Redemption Price without interest upon surrender of their certificate or certificates therefor.

(e) Redeemed or Otherwise Acquired Shares. Any shares of Series A Preferred Stock which are redeemed or otherwise acquired by the Corporation or any of its subsidiaries shall be automatically and immediately cancelled and retired and shall not be reissued, sold or transferred. Neither the Corporation nor any of its subsidiaries may exercise any voting or other rights granted to the holders of Series A Preferred Stock following redemption.

7. Waiver. [Any of the rights, powers, preferences or other terms of the Series A Preferred Stock set forth herein may be waived on behalf of all holders of Series A Preferred Stock by the affirmative written consent or vote of the holders of at least [specify percentage][100] of the shares of Series A Preferred Stock then outstanding.][101]

8. Notices. Any notice required or permitted by the provisions of this Article Fourth to be given to a holder of shares of Series A Preferred Stock shall be mailed, postage prepaid, to the post office address last shown on the records of the Corporation, or given by electronic communication in compliance with the provisions of the General Corporation Law, and shall be deemed sent upon such mailing or electronic transmission.

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[100] As discussed in the introductory commentary to this form, Corporations Code § 710 bars super-majority voting requirements in excess of 66 2/3 % for most public and many private California corporations.

[101] Practitioners report that Staff Counsel in the Secretary of State's Office has stated that general prospective waivers are invalid under Corporations Code §§202(e)(3), 902 and 903 because any change to the rights, preferences, privileges and restrictions of the Preferred Stock must be made by an amendment of the Articles of Incorporation. But this provision may pass muster if not seen as general prospective waiver. Some practitioners have reported that narrowly tailored waiver provisions, for example addressing only the waiver of anti-dilution protection in prescribed circumstances, may be accepted for filing by the Secretary of State's Office. Alternatively, pursuant to Section 110(b) of the Corporations Code, counsel may submit a written opinion along with the proposed instrument, in which case the "Secretary of State shall rely" on the opinion with respect to the disputed points of law. A waiver of terms of Preferred Stock by a vote of the holders authorized by the articles would appear to be part of the rights, preferences, privileges and restrictions of the Preferred Stock.

FIFTH: To the fullest extent permitted by law, a director of the Corporation shall not be personally liable to the Corporation or its shareholders for monetary damages for breach of fiduciary duty as a director. If the General Corporation Law or any other law of the State of California is amended after approval by the shareholders of this Article Fifth to authorize corporate action further eliminating or limiting the personal liability of directors, then the liability of a director of the Corporation shall be eliminated or limited to the fullest extent permitted by the General Corporation Law as so amended.[102]

Any repeal or modification of the foregoing provisions of this Article Fifth by the shareholders of the Corporation shall not adversely affect any right or protection of a director of the Corporation existing at the time of, or increase the liability of any director of the Corporation with respect to any acts or omissions of such director occurring prior to, such repeal or modification.

SIXTH: To the fullest extent permitted by applicable law, the Corporation is authorized to provide indemnification of (and advancement of expenses to) directors, officers and agents of the Corporation (and any other persons to which the General Corporation Law permits the Corporation to provide indemnification) through Bylaw provisions, agreements with such agents or other persons, vote of shareholders or disinterested directors or otherwise, in excess of the indemnification and advancement otherwise permitted by Section 317 of the Corporations Code.

Any amendment, repeal or modification of the foregoing provisions of this Article Sixth shall not adversely affect any right or protection of any director, officer or other agent of the Corporation existing at the time of such amendment, repeal or modification.[103]

SEVENTH: [To the extent permitted by applicable law, the Corporation renounces any interest or expectancy of the Corporation in, or in being offered an opportunity to participate in, any Excluded Opportunity. An "**Excluded Opportunity**" is [any matter, transaction or interest that is presented to, or acquired, created or developed by, or which otherwise comes into the possession of, (i) any director of the Corporation who is not an employee of the Corporation or any of its subsidiaries, or (ii) any holder of Series A Preferred Stock or any partner, member, director, shareholder, employee or agent of any such holder, other than someone who is an employee of the Corporation or any of its subsidiaries (collectively, "**Covered Persons**"), unless such matter, transaction or interest is presented to, or acquired,

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[102] Corporations Code §§ 204(a)(10) and 309(c) do not allow corporations to eliminate liability of directors for (1) intentional misconduct; (2) bad faith or breach of duty of loyalty; (3) any transaction in which director derived improper personal benefit; (4) "reckless disregard of duty"; (5) "abdication of duty"; (6) transactions between corporation and director or corporations having interrelated directors per Corporations Code § 310; or (7) unlawful distributions per Corporations Code § 316.

[103] This provision authorizes the indemnification of directors, officers and agents of the Corporation, but does not require it. Investors who have the right or ability to appoint affiliates to the Board of Directors often request that more detailed, mandatory indemnification provisions be included in the Articles of Incorporation or Bylaws, and/or indemnification contracts and insurance coverage. A form of mandatory indemnification provision that could be inserted in this Article Sixth in place of the above is attached as Exhibit A.

created or developed by, or otherwise comes into the possession of, a Covered Person expressly and solely in such Covered Person's capacity as a director of the Corporation].]

[Comment: Corporations Code §204(d) permits a Corporation to include in its Articles of Incorporation "any … provision, not in conflict with law, for the management of the business and for the conduct of the affairs of the corporation …"[104]

This provision enables a Corporation to determine in advance whether the described opportunities are corporate opportunities of the Corporation rather than to address such opportunities as they arise. Venture Capital investors may be concerned about having to provide these opportunities to the Corporation and thus may seek this type of provision. Note that the defined term "Excluded Opportunity" in the above example is very pro-investor. The foregoing Article Ninth is merely an example of such a provision, and is not necessarily an appropriate starting point for any particular transaction.]

EIGHTH: In connection with repurchases by the Corporation of its Common Stock from employees, officers, directors, advisors, consultants or other persons performing services for the Corporation or any subsidiary pursuant to agreements under which the Corporation has the option to repurchase such shares at cost upon the occurrence of certain events, such as the termination of employment, Sections 502 and 503 of the Corporations Code shall not apply in all or in part with respect to such repurchases.

[Comment: Sections 502 and 503 of the Corporations Code set forth the financial rules governing when a corporation may redeem shares of stock that are junior to outstanding shares of more senior stock. Section 402.5 of the Corporations Code allows the corporation and the holders of Preferred Stock to opt out of the provisions of Sections 502 and 503 in the Articles of Incorporation.]

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3. The Restated Articles of Incorporation have been duly approved by the board of directors.

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[104] Section 122(17) of the DGCL expressly permits a corporation to renounce in its Certificate of Incorporation the corporation's interest or expectancy in specified business opportunities or specified classes or categories of business opportunities. The Corporations Code contains no similarly detailed authorizing provision. The extent to which a provision like Article Seventh would limit a California court's application of the corporate opportunity doctrine, which takes into account not only the manner in which the opportunity is presented to a director or officer but also the similarity of the opportunity and the business of the corporation, the ability of the corporation to take advantage of the opportunity, and the desire of the corporation to expand its business (*see* Marsh's California Corporation Law §11.12 (4th ed. 2005)), has yet to be determined.

4. The amendments to the Articles included in the Restated Articles of Incorporation (other than the omissions required by Section 910 of the Corporations Code) have been duly approved by the required vote of the shareholders in accordance with Section 902 of the Corporations Code. The Corporation has only one class of shares and the number of outstanding shares is [number]. The number of shares voting in favor of the amendments equaled or exceeded the vote required. The percentage vote required for the approval of the amendments was more than 50%.

/s/_____
[Name and Title]

/s/_____
[Name and Title]

The undersigned declares this [date] at [City, County, State] under penalty of perjury under the laws of the State of California that [he/she] has read the foregoing certificate and knows the contents thereof and that the same is true of [his/her] own knowledge.

/s/_____

The undersigned declares this [date] at [City, County, State] under penalty of perjury under the laws of the State of California that [he/she] has read the foregoing certificate and knows the contents thereof and that the same is true of [his/her] own knowledge.

/s/_____

[Comment: See Corporations Code §§173 and 910 for the requirements regarding the execution of the certificate of the Restated Articles of Incorporation.]

Exhibit A

SIXTH: The following indemnification provisions shall apply to the persons enumerated below.

1. Right to Indemnification of Directors and Officers. The Corporation shall indemnify and hold harmless, to the fullest extent permitted by applicable law as it presently exists or may hereafter be amended, any person (an "**Indemnified Person**") who was or is made or is threatened to be made a party or is otherwise involved in any action, suit or proceeding, whether civil, criminal, administrative or investigative (a "**Proceeding**"), by reason of the fact that such person is or was a director or officer of the Corporation or, while a director or officer of the Corporation, is or was serving at the request of the Corporation as a director, officer, employee or agent of another Corporation or of a partnership, joint venture, limited liability company, trust, enterprise or nonprofit entity, including service with respect to employee benefit plans, against all liability and loss suffered and expenses (including attorneys' fees) reasonably incurred by such Indemnified Person in such Proceeding.

2. Prepayment of Expenses of Directors and Officers. The Corporation shall pay the expenses (including attorneys' fees) incurred by an Indemnified Person in defending any Proceeding in advance of its final disposition, provided, however, that, to the extent required by law, such payment of expenses in advance of the final disposition of the Proceeding shall be made only upon receipt of an undertaking by the Indemnified Person to repay all amounts advanced if it should be ultimately determined that the Indemnified Person is not entitled to be indemnified under this Article Sixth or otherwise.

3. Claims by Directors and Officers. If a claim for indemnification or advancement of expenses under this Article Sixth is not paid in full within 30 days after a written claim therefor by the Indemnified Person has been received by the Corporation, the Indemnified Person may file suit to recover the unpaid amount of such claim and, if successful in whole or in part, shall be entitled to be paid the expense of prosecuting such claim. In any such action the Corporation shall have the burden of proving that the Indemnified Person is not entitled to the requested indemnification or advancement of expenses under applicable law.

4. Indemnification of Employees and Agents. The Corporation may indemnify and advance expenses to any person who was or is made or is threatened to be made or is otherwise involved in any Proceeding by reason of the fact that such person is or was an employee or agent of the Corporation or, while an employee or agent of the Corporation, is or was serving at the request of the Corporation as a director, officer, employee or agent of another corporation or of a partnership, joint venture, limited liability company, trust, enterprise or nonprofit entity, including service with respect to employee benefit plans, against all liability and loss suffered and expenses (including attorney's fees) reasonably incurred by such person in connection with such Proceeding. The ultimate determination of entitlement to indemnification of persons who are non-director or officer employees or agents shall be made in such manner as is determined by the Board of Directors in its sole discretion.

5. Advancement of Expenses of Employees and Agents. The Corporation may pay the expenses (including attorney's fees) incurred by an employee or agent in defending any Proceeding in advance of its final disposition on such terms and conditions as may be determined by the Board of Directors.

6. Non-Exclusivity of Rights. The rights conferred on any person by this Article Sixth shall not be exclusive of any other rights which such person may have or hereafter acquire under any statute, provision of the Articles of Incorporation, these by-laws, agreement, vote of shareholders or disinterested directors or otherwise.

7. Other Indemnification. The Corporation's obligation, if any, to indemnify any person who was or is serving at its request as a director, officer or employee of another Corporation, partnership, limited liability company, joint venture, trust, organization or other enterprise shall be reduced by any amount such person may collect as indemnification from such other Corporation, partnership, limited liability company, joint venture, trust, organization or other enterprise.

8. Insurance. The Board of Directors may, to the full extent permitted by applicable law as it presently exists, or may hereafter be amended from time to time, authorize an appropriate officer or officers to purchase and maintain at the Corporation's expense insurance: (a) to indemnify the Corporation for any obligation which it incurs as a result of the indemnification of directors, officers and employees under the provisions of this Article Sixth; and (b) to indemnify or insure directors, officers and employees against liability in instances in which they may not otherwise be indemnified by the Corporation under the provisions of this Article Sixth.

9. Amendment or Repeal. Any repeal or modification of the foregoing provisions of this Article Sixth shall not adversely affect any right or protection hereunder of any person in respect of any act or omission occurring prior to the time of such repeal or modification. The rights provided hereunder shall inure to the benefit of any Indemnified Person and such person's heirs, executors and administrators.